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The Canadian Chartered Accountant

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by Glen E. Martin
- The Viewpoint of Quebec's Government
by Hon. J. Onesime Gagnon
- "Accounting for Inflation"
by Kenneth F. Byrd
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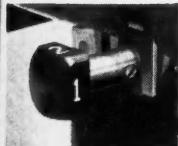
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The Canadian Chartered Accountant

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JANUARY 1953

NUMBER 1

COMMENT AND OPINION

1953!

IN NOVEMBER and December of last year editors of countless periodicals all over the world faced up to the problem of trying to write something new and original for their first number of the new year. We rather imagine that, so far as the "new and original" aspect is concerned, the thing hasn't been done very often, if indeed more than once, and we shan't try very hard.

Most of us ordinary human beings are probably concerned with matters pretty close to home, our family, our work, our prospects, and for Canadians at least the prospects for 1953 are certainly good. One has the impression that the same may be said for a great part of the rest of the world also, though one could wish that it could be true for everyone everywhere, whatever their race, colour, creed or social ideology. Today's headline words, "Korea", "Iron Curtain", "Apartheid", "Mau Mau", "Indo-China", and "Malaya" indicate forcibly, however, that utopia is still far away, and that it may be farther before it is nearer.

However that may be, the editorial committee and editors of *The Canadian Chartered Accountant* sincerely extend to all their readers the wish that they may all enjoy peace and prosperity in 1953.

The Sixth Tax Conference

YEAR by year the annual conferences of the Canadian Tax Foundation are

getting bigger and better. The last, held in Montreal in November, was, we understand, the most largely attended of any yet held and, in our judgment, both for the manner in which it was conducted and the intrinsic interest of the matters discussed, it also takes the foremost place. While the masthead of *The Canadian Chartered Accountant* contains the caution: "Opinions expressed in articles and comment are not necessarily endorsed by The Canadian Institute of Chartered Accountants", we are sure that we express the view of all our members who attended the Sixth Tax Conference in saying to the governors and staff of the Foundation "Well Done!"

Income Splitting Twixt Spouses

One of the most interesting discussions we have heard on the subject of taxation (can that ever be interesting? some reader will exclaim) was that devoted to the above subject at the Tax Conference.

In speaking of income splitting between spouses we are not, of course, referring to that phenomenon with which every married man is familiar, but to the possibility of it being recognized in the tax law, which until now has proceeded on the assumption that all of a husband's income is actually his. Of course, we concede that no great injustice results from this patently absurd assumption if everyone is treated alike and if adequate tax exemptions are granted for

the financial burdens resulting from the marital obligation, and we confess we have never heard any vociferous protests on those matters. Why then should the subject be raised at all?

Well, all is not such plain sailing as one would think. It appears that the Province of Quebec recognizes the system of community of property between a husband and wife (although it is possible to contract out of it prior to marriage), and, as we understand it, the income of a husband who is common as to property with his wife, belongs not to him although he has the exclusive management and control of it, but to the community, consisting of himself and his wife. That being so, the argument proceeds, the whole of the income cannot be deemed to be the income of the husband for tax purposes and taxed as such. Just whose income it really is we are not able to say because the fact is that as yet no Quebec taxpayer has sought to raise the issue in the courts.

Now it so happens that the very same situation existed in the United States, where several of the States (those originally colonized by Spain and France, among them California and Louisiana), also recognize community of property. The Supreme Court of the United States adjudged that in those States the income of the husband or the wife, as the case might be, should be equally apportioned between the spouses for tax purposes, with the result that the total tax (being calculated at lower graduated rates) was less, in some cases very much less, than if it were all treated as the income of one person. Some of the other States, desiring to benefit their citizens in the same way, then introduced community of property into their own laws, heedless of the revolution it would collaterally

effect in the relationship of married persons in regard to their separate property. But this came to naught when the Supreme Court of the United States held that the introduction of community property by these States was ineffective for tax purposes. Tax rates being what they were, a situation which discriminated between citizens simply by reason of the accident of their residence in a particular State could not be allowed to continue, and the result was an amendment to the United States Internal Revenue Code to permit a husband and wife to divide their combined income between them for tax purposes. The effect of this amendment was, however, not merely to equalize the situation as between the citizens of all States, but also to reduce very substantially the proportion of the total tax paid by married persons in the middle and upper income classes (because of the application of lower graduated rates).

If the question should ever arise in Canada it is, of course, possible that the Supreme Court of Canada may take a different view than did the Supreme Court of the United States and adjudge that a husband or wife, as the case may be, shall, for tax purposes at least, be deemed to receive the income which Quebec law attributes to the community. On the other hand, it may take the same view as was taken below the border. Should it do so, it seems certain that Parliament would be called on to act, but we rather doubt that the American solution would commend itself to our legislators. The question is one of considerable interest, but whether it will ever become one of importance depends to some extent on the hardihood of an as yet unknown Quebec citizen who is common as to property.

A Business-Survey Approach to Auditing

By Glen E. Martin, C.P.A.

To-day's auditor must be a keen
analyst of a company's financial and operating trends

ACCOUNTING, among other things, is responsible under proper guidance for the recording of business transactions, for the control of business operations, and for the interpretation of operating results. It measures current performance against prior performance or against estimates or budgets. It measures the efficiency of executives responsible for departmental results. It provides the means of forecasting financial and operating results, of budgeting and of establishing future financial policies. Accounting, therefore, is the language of business and to understand accounting the independent public accountant must have a good understanding of the business factors.

Growth of Internal Control

In the early days of the public accounting profession when business organizations were relatively simple and operations moved at a slower pace, it was the general practice of independent public accountants to do a considerable amount of detailed checking and, in many instances, to check all of the transactions. As business became more complex with the development of

greater speed and volume, extensive detailed checking by independent public accountants became impracticable and internal control procedures along with internal auditing were developed to help maintain the integrity of the accounts. Concurrently with the growth in our economy it has been necessary for independent accountants to acquire skills which would enable them to apply appropriate testing and sampling procedures for the purpose of arriving at an opinion as to the financial statements.

The larger, more complicated business structures in existence today have made it necessary for managements to set up methods for the proper control of their operations. In this respect they frequently request assistance from independent public accountants. Consequently, in addition to the development of more progressive auditing procedures, the accountants have had to expand their knowledge of business operations and provide experts in various specialized fields, in order to render the types of services which their clients may rightfully expect.

In view of all of these far-reaching

An address to the Hamilton and District C.A. Association, Nov 12, 1952

changes and growing problems, the "figure-checking" auditor of earlier years has become a more imaginative auditor as well as a keen analyst of financial and operating data. To be most effective in the exercise of these qualities during the progress of his work and to solve the problems relating to accounting policies and financial statement presentation, the professional accountant must have at least a broad knowledge of the operations of his client. Extensive testing and sampling of the figures, without first formulating an appropriate plan of procedure based on an understanding of the client's business operations, tends to be inefficient and to restrict the services which may be rendered by the independent public accountant. Today the accountant must look at his client's business not simply from the viewpoint of that of a technical accountant but from the viewpoints of the business manager, the economist, and the engineer. It therefore follows that if the accountant can devise methods of accumulating more general information regarding the business of his client and the problems of its management, he can improve the efficiency of his auditing work and render more valuable service. One method of acquiring such information would be through the adoption of a plan for making a brief survey of the business prior to undertaking the more detailed aspects of the engagement. Such a plan, which may be called "a business-survey approach to auditing", should enable the independent public accountant to determine more intelligently the points which should be stressed in his examination and to be of greater assistance to his client in other respects.

While my comments relate particularly to the work of the public accountant, a similar program may be undertaken by the internal auditor or con-

troller or anyone else interested in a broad picture of the business.

In the case of the ordinary audit, the survey cannot of course be as extensive as that which might be undertaken by a management engineer employed specifically for that purpose. In programming his audit, however, the accountant should be able to budget anywhere from a few hours to a few days (depending on the relative size of the operations) for the survey, because it is probable that he will save at least that much time by the more efficient auditing which will follow the broader knowledge of the client's affairs. The information obtained from the business survey would be placed in the accountants' permanent file and in subsequent annual examinations would be reviewed and brought down to date. Furthermore, in each annual examination the accountant could review in more detail some particular department or activity of the business, with the object of developing over a period of years quite a complete summary of the business operations. The information which the auditor may want to obtain and study in connection with audit engagements is set forth in the paragraphs which follow. Where the decision has been made to accumulate such information it would be preferable to begin the undertaking early in the engagement, with respect to annual examinations it would be done at the beginning of preliminary or interim work.

Financial and Operating Trends

The auditor may find it worth while in many instances to study the financial and operating trends of the client's business and its position in the industry of which it is a member. This study could begin by obtaining comparative annual balance sheets, earnings state-

ments and statements of application of funds, all for a period of years, perhaps five years, or perhaps more if a longer period appears to have significance. In addition, if the client is a member of a well-defined industry and the financial statements of comparable competitors are available, similar comparative financial statements of at least two or three of such competitors may be obtained or prepared. Operating ratios and statistics, if published by the industry, may also be obtained. A study of gross profit ratios, ratios of expenses to sales or revenue, working capital ratios, receivable and inventory turnovers, etc. and a comparison between the client and its competitors or between the client and the industry would enable the auditor to form an opinion as to the trend of his client's business in relation to others in the industry. Of further assistance in this respect would be any published study of the particular industry which might be available. As the auditor progresses in the study of those trends, he may in the case of his client want to obtain supporting statements in more detail, such as those showing the trends of sales or revenues, costs and expenses, operating results by departments, etc. Many of such statements will have been prepared previously by the controller and will be available for the auditors' review.

It is particularly significant at present, when broad economic changes are taking place, to study financial and operating trends over a period of years. The viewpoint of the auditor, the investor, the management, the stockholder or any interested person when confined to the financial statements of one year compared with the preceding year may be meaningless. This fact is gradually becoming recognized as it is noted that more and more corporations

Mr. Glen E. Martin, C.P.A. is a partner in the firm of Peat, Marwick, Mitchell & Co., Accountants and Auditors, Chicago, and has been engaged in public accounting for approximately 25 years. He is assistant editor of "The CPA", a publication of the Illinois Certified Public Accountants' Association, and is also a member of the Committee on Cooperation with the Securities Exchange Commission (5 men) of the American Institute of Accountants.

are adopting the policy of showing unaudited condensed financial statements covering a series of years in their annual reports to their stockholders. In prognosticating future operating results, bankers, stockholders, and investors must rely to a large extent on past performance over a sufficiently long period of an economic cycle to have some meaning. This has led to the placing of more emphasis on the income statement as an indication of the earning power of a corporation.

Regardless of the manner in which the auditor approaches the problem, the objective is to ascertain the operating and financial trends within the company and find out the reasons therefor. The reasons may be internal and therefore under the control of the management or they may be external and beyond the control of the management. In either event the facts will be helpful to the auditor in determining the scope of his examination and in arriving at his conclusions, and may enable him to offer constructive suggestions to his client.

Organization Chart

In most cases the auditor will want to obtain a copy of the company's

organization chart, or if one is not available he may construct a simple chart. The names and general responsibilities of the principal executives might be shown and there may be indicated the names and duties of the financial and accounting personnel with whom contact may be made.

History of the Enterprise

The auditor will want to know something of the historical background of his client. This would include a summary of its capital structure, showing the source of its capital, data with respect to any mergers or consolidations which may have taken place and information with respect to any new departments that may have been added or new products that may have been introduced. All of this information may be obtained by analyzing the capital stock and surplus accounts, reviewing the minutes of the board of directors and stockholders, reviewing auditors' reports or internal financial statements of prior years, and by discussions with the management.

Manufacturing Operations

Assuming that the auditor is dealing with a manufacturing client, it would be helpful to have some knowledge of the following:

- Location and size of plants.
- Sources of principal items of raw material.
- Methods of transporting raw materials to plants.
- Sources of labour supply, methods of compensation, labour relations, etc.
- Methods of controlling production and inventories.
- Policies with respect to research.

Obtaining information with respect to the foregoing will involve principally trips through the plants and discussions with plant superintendents and other personnel.

Distribution

General information regarding the company's distribution policies and procedures, such as the following, may be obtained by discussion with responsible officials:

- Methods of distribution, that is, through wholesalers, retailers, etc.
- Territories covered and methods of transporting products.
- Policies with respect to compensation to salesmen.
- Problems of seasonal demand.
- Pricing policies.
- Promotion and advertising policies.
- Credit and collection policies.
- Problems, if any, with respect to servicing product.

Financial Policies

The auditor will ordinarily ascertain the company's financial policies with respect to such matters as the following:

- Maintenance of working capital.
- Short term borrowing to meet seasonal demands.
- Funded debt and plans for repayment or re-funding.
- Policies with respect to financing of suppliers or customers.

Preliminary Review of Accounting Principles and Procedures

In connection with the auditor's preliminary work, he should review the client's policies with respect to the more important accounting principles. Among those on which he will want information are the following:

- Allowances for doubtful receivables and other receivable adjustments.
- Inventory pricing.
- Capitalization of property additions and maintenance.
- Allowances for depreciation, amortization and depletion.
- Amortization of prepaid expenses and deferred charges.
- Provisions for taxes and other expense accruals.

Among the more important accounting procedures on which the auditor will want information during his preliminary work are the following:

- Recording of charge sales both as to revenue accounts and accounts receivable.
- Recording of cash sales.
- Recording of purchase invoices and classification of charges.
- Payroll records and distribution of charges.
- Recording and classification of cash receipts and disbursements.
- Cost accumulating and distribution procedures, in the case of manufacturing companies.

The Controller's Internal Reports to Management

One of the weaknesses in many business organizations is found in internal reporting to management. Adequate internal reports are necessary for efficient control of business operations and can be of great assistance to management in the prompt application of corrective measures to overcome adverse trends. Many internal reports are prepared by subordinates without adequate supervision, tend to follow a prescribed pattern and become stereotyped, and do not speak the language of management. The increasing complexity and size of business operations and narrowing of profit margins under greater competition call for the preparation of high quality reports to management.

From a study of his client's internal reports, the auditor may be able to offer suggestions for improvement or at least a suggestion that a survey be made with that object in mind. The auditor will also find in internal reports, in many instances, information which will be helpful to him in conducting his audit.

Effective internal reporting cannot follow a fixed pattern — it must reflect the kind of information management

requires and must therefore change with operating conditions and the ideas of management. Briefly speaking, internal reports should:

- Be expressed in business language commonly used by management.
- Set forth the basic facts needed to run the business.
- Emphasize the important trends and factors of interest to management and avoid unnecessary details.
- Make use of summaries, brief tables of informative highlights, and graphs and charts.

While it is not possible to outline specifically the content of internal reports, we may say generally that such reports issued to top management would probably include data similar to the following, set forth in comparative form. The comparisons might be with preceding periods or with budgets. In some instances current results and positions will be compared with applicable data over a significant period of years when trends are in evidence which should be watched by management:

1. Highlights of recent financial and operating trends.
2. Balance sheet.
3. Working capital summaries.
4. Statement of application of funds.
5. Summary of cash balances.
6. Significant data, if any, with respect to receivables.
7. Analysis of inventories.
8. Summary of fixed property accounts and accumulated depreciation allowances.
9. Summary of accrued federal income taxes.
10. Information regarding purchase commitments.
11. Summary of surplus (retained earnings).
12. Statement of income.
13. Statement of cost of sales.
14. Statement of selling, general and administrative expenses.
15. Sales summary.
16. Basic material price trends.
17. In some cases, product costs and net profits.

18. Significant operating and turnover ratios.
19. Summary of basic facts required to operate the business.
20. Charts and graphs illustrating significant trends.
21. Interpretative comments.

Objectives of a Business-Survey Approach to Auditing

It appears that an auditor should have three principal objectives in mind when he adopts a business-survey approach to his work. First, an approach along these lines will make his work far more interesting. Instead of thinking too much about the mechanical checking of figures, he will be thinking more about what is behind the figures and how they are related to the business operations. Thus, he tends to challenge and develop his imagination and to make his work more romantic and exciting.

His second objective should be to improve the effectiveness of his auditing procedures. A better knowledge of the business operations of his client, and the trends of those operations as reflected in internal accounting and financial reports, will tend to point out to the imaginative auditor the centres of strength and weakness which should be considered in programming the audit. Such knowledge will also aid the auditor in the interpretation of the answers secured from the investigation of the system of internal control and therefore should enable him to tailor his audit program more effectively to accord with that system. Consequently, he is more likely to direct his detailed-checking operations toward the weak spots and eliminate unnecessary work in strong spots.

The third objective in the business-survey approach should be to search out opportunities to suggest improve-

ments for the consideration of clients. A broader knowledge of his client's business operations will certainly furnish the auditor with more ideas to be sifted and related to each other. And from these ideas he is likely to form some opinions as to beneficial changes which may be passed on to the client for the consideration of the management.

In the paragraphs which follow, examples will be given of the results which may be expected under the second and third objectives set forth above.

Improving the Effectiveness of Auditing Procedures

Examples of how a business-survey approach may improve the effectiveness of auditing are listed below. These are illustrative only; many other examples will come to the reader's mind:

1. A review of the trends of financial and operating ratios may direct attention to:
 - a. An expansion in inventories in relation to sales, which will be investigated to ascertain whether the inventories are properly priced.
 - b. An increase in the number of days' sales outstanding in receivables, which would warrant more attention to these items and the related allowance for doubtful accounts.
 - c. Changes in profit margins in total or by departments or products, which may raise a question as to the reasonableness of the operating accounts or of the inventories.
 - d. Down trends in sales in certain departments or of certain products which may indicate the need of reserves against receivables or inventories.
 - e. Variations in ratios of certain expenses to sales, which would be questioned as to reasonableness.
2. A comparison of the trends in the client's business with others in the industry may indicate over-extended receivable or in

- ventory positions, inadequate allowances for depreciation, high or low costs, etc.
3. A review of the company's organization chart may indicate an improper division of duties with consequent weaknesses in internal control.
 4. A knowledge of the general layout of the manufacturing plants will be helpful in determining the extent to which property additions should be checked and the extent to which inventories should be examined.
 5. A trip through the manufacturing plant or plants may disclose the extent generally to which equipment has been retired and replaced.
 6. Ascertainment of the principal items of raw materials and their sources will result in concentrating the audit operations on the more important elements of costs and the verification of liabilities to the principal creditors.
 7. Information as to the methods of transporting raw materials to plants will assist the auditor in determining that transportation costs have been handled properly in the accounts.
 8. A knowledge of the sources of labour supply, methods of compensating labour, relations with labour unions, etc. will be helpful in verifying the allocation of labour costs, accrued wages, social security taxes, etc.
 9. A review of the methods of controlling production and inventories will make possible a more intelligent approach to the verification of inventory quantities and pricing and commitments.
 10. Information regarding the handling of waste materials and returned products and containers will be helpful in the verification of the accounts relating to these items.
 11. An inquiry into research policies will help the auditor relate the facts to the accounts, verify the amortization of patents, and check the costs of new products.
 12. A review of the methods of distribution will be helpful in the determination of the extent of the circularization of receivables, the adequacy of the allowances for doubtful accounts and the reasonableness of the policies with respect to returned merchandise.
 13. A knowledge of the methods of transporting products will be helpful to the auditor in ascertaining that the transportation charges have been handled appropriately.
 14. A study of the methods of compensating salesmen will furnish the auditor with the basic information required for the determination that appropriate accruals are set up for salaries, commissions, bonuses, etc.
 15. A review of seasonal demand cycles will be helpful in planning the audit program with respect to receivables and inventories and the extent of the preliminary or interim work.
 16. A review of product-pricing policies may be of help to the auditor in his check of inventory costs.
 17. Information regarding the policies with respect to promotion and advertising will help the auditor to make a better determination that the costs of these items are reflected properly in the accounts and that the appropriate liabilities are set up.
 18. A determination of the company's credit and collection policies will be helpful in determining the adequacy of the control over receivables and the reasonableness of the allowance for doubtful receivables.
 19. An investigation of the company's experience with respect to servicing its products, and possible guarantees in connection therewith, may point to the need of accruing such costs currently.
 20. A review of the controller's internal reports to management may disclose points of strength or weakness which should be considered in programming the audit.
 21. A review of internal audit reports and cooperation with the internal auditors in the detailed testing operations will result in more effective auditing and a saving of time.

Suggestions to Management

As previously stated, a better knowledge of business operations will enable the auditor to make more worth-while

suggestions to management. Examples of how such information may be put to useful purposes are listed in the paragraphs which follow. While the auditor cannot in all cases make specific recommendations, he can at least call such matters to the attention of his client for consideration. Also, it should be understood that the auditor will not have the time to develop a lot of ideas in any one year, unless employed for that specific purpose, but new thoughts are likely to occur to him from year to year. It is of course recognized that many progressive managements will be fully aware of possibilities for improvements and will take the necessary action. On the other hand independent auditors with a detached view may see possibilities not readily discernible to managements.

1. A study of financial and operating trends over a reasonable period of time may indicate the need of:

- a. Cost reduction or selling price changes.
- b. Elimination of certain departments or products.
- c. Acquisition of complementary lines of products.
- d. Reduction in certain types of expenses.
- e. Improvement in credit and collection policies.
- f. Better control over inventories.
- g. Additional working capital.
- h. Possible additional financing.
- i. Retention of a larger portion of earnings through reduction in dividends.
- j. A change in the corporate capital structure.

2. A comparison of a client's financial and operating ratios with others in the industry may reveal these possibilities:

- a. The need for corrective action in any department or category of the business which appears to be out of line with the industry.
- b. The desirability of increasing sales efforts and advertising appropriations.
- c. The advisability of changes in labour or personnel policies.
- d. The advantages of plant relocations

and reorganization of manufacturing operations.

- e. Changes in credit and collection policies to reduce outstanding receivables.
- f. Better control over inventories to reduce amounts invested therein.
- g. The necessity of additional capital, either borrowed or equity.
- h. The advisability of plant expansion or contraction.
- i. Consideration of whether it is preferable to own or rent properties or equipment.

3. A look at the organization chart may suggest possibilities of changes to improve the efficiency of operations or the controls over operations.

4. A general knowledge as to the location and size of plants, when related to other factors, may suggest possibilities of moving or merging operations or discontinuance of unprofitable plants.

5. A knowledge of the sources of the principal items of raw material may be the basis of considering sources nearer to plants or from certain suppliers capable of quicker delivery or delivery in larger quantities.

6. Information as to methods of transporting raw materials to plants may lead to consideration of more efficient or faster means of transportation, a change in the source of materials, or a change in plant location.

7. A general knowledge of the sources of labour supply, methods of compensation, labour relations, etc. may suggest possibilities of new sources of labour, changes in methods of compensation, adoption of incentive plans, or adoption of pension plans.

8. An investigation of the methods of controlling production and inventories may indicate the need of:

- a new system of controlling production;
- an improved cost system;
- a system for proper control of inventory quantities.

9. A knowledge of the methods of distribution may suggest a study to determine cheaper, quicker, or more efficient methods.

10. A review of sales territories and methods of transporting products may indicate the desirability of territorial changes (such as expansions, contractions, or mergers) or the adoption of more efficient methods of transporting products to consumers.
11. A study of the client's policies as to compensation to salesmen may disclose the need to revise commission rates, establish incentive bonuses, or make other remedial changes.
12. Consideration of problems of seasonal demand may suggest ways and means of maintaining normal production, of financing working capital requirements, etc.
13. A review of pricing policies may indicate the need of revision or of more reliable cost information.
14. Considerations of policies with respect to promotion and advertising may point up the desirability of expansion or contraction of expenditures or of a different approach.
15. Information regarding credit and collection policies when related to other business factors may suggest changes in credit terms, billing procedures, or follow-up on collections.
16. A study of the company's financial policies may indicate the desirability of:
 - a. providing additional working capital;
 - b. adopting new methods of financing;
 - c. obtaining additional equity capital or long-term loans;
 - d. reducing dividend payments;
 - e. reorganization of stockholders' equity structure;
 - f. acquiring new businesses;
 - g. merging with other businesses.
17. A review of the company's accounting principles and procedures may disclose opportunities to suggest:
 - a. a survey of the accounting system and procedures;
 - b. an improved cost system;
 - c. revised inventory and production control procedures;
 - d. a survey of internal accounting forms to detect possibilities of reduction;
 - e. a simplification of office and bookkeeping procedures;
 - f. the installation of bookkeeping or tabulating machines.
18. A survey of the controller's operating and financial reports to management may result in suggesting that more informative reports be developed and an appropriate financial and operating budget system be installed.

A Program for Developing the Business-Survey Approach

The development of a business-survey approach to auditing as commonly accepted procedure would require long-range educational planning. Some methods would have to be adopted to insure progress in the right direction. For example, it appears desirable, in connection with staff meetings, round table discussions, and training sessions, to stress the importance of developing more knowledge about the business under audit. Professional accounting organizations might also discuss the subject in connection with technical meetings. The colleges and universities, in connection with their courses in auditing, might also emphasize a business-survey approach to the work. Finally, if we were to develop a basic program (to be used, say, in a typical manufacturing company) for obtaining more useful information about the business to be audited, we might start with something along the following lines:

AUDIT PROGRAM

General Approach and Preliminary Survey

Obtain copies of the company's financial statements (including balance sheets, statements of income, statements of retained earnings, statements of application of funds, reports of departmental operating results, etc.) for the preceding — years and to a recent interim date in the current year.

Study the trends and operating and

financial ratios shown by the aforementioned statements in order to gain a background knowledge of the company and to determine points which should be emphasized in the current audit.

If the company is a member of a well-defined industry, ascertain the company's position in the industry by reviewing available published studies and obtaining (if publicly available) comparative financial statements covering a period of years of two or three comparable competitors. Compare the trends and operating and financial ratios evident from the competitors' statements with those of the client.

Prepare a general statement for the permanent file showing the nature of the company's operations, location and size of plants, and physical properties.

Obtain or prepare an organization chart.

In order to obtain a general knowledge of the client's business and operations, and the reasons back of the figures, inquire into the following factors and prepare a brief statement for the permanent file setting forth the significant facts:

1. Sources of principal items of raw materials.
2. Methods of transporting raw materials to plants.
3. Sources of labour supply, methods of compensation, labour relations, etc.
4. Methods of controlling production and inventories.
5. Policies with respect to research.
6. Methods of distribution, that is, through wholesalers, retailers, etc.
7. Sales territories covered and methods of transporting products.
8. Policies with respect to compensation of salesmen.

9. Problems of seasonal demand.
10. Pricing policies.
11. Promotion and advertising policies.
12. Credit and collection policies.
13. Problems, if any, with respect to servicing product.
14. Other matters of significance.

Review the system of internal control or bring down to date previous reviews and supply appropriate answers to the internal control questionnaire.

Review generally the accounting procedures or bring down to date previous reviews, and note any improvements which could be made to provide better control of operations, reduce costs, or furnish more informative reports to management.

Review the company's internal financial and operating reports for significant information having a bearing on the audit and for the purpose of ascertaining if they can be improved to provide management with adequate information and significant facts required for proper control of operations.

Inquire as to the possible use of budgets for improving control over operations and forecasting.

On the basis of the information obtained from the foregoing reviews, determine the points which should be emphasized in connection with the audit and note them below.

Draft a letter to the management setting forth suggested improvements in the system of internal control and accounting procedures and any other matters noted in connection with the audit which should be considered by the management.

"Accounting for Inflation"

By Kenneth F. Byrd, M.A., B.Sc. (Econ.), A.C.A.
Professor of Accounting, McGill University

A comment by way of review of "Accounting for Inflation", a Study by The Taxation and Research Committee of The Association of Certified and Corporate Accountants; published by Gee & Co., London; pp. 149; price 15/-

Those of us who feel that something should be done to reduce the fictional content of financial statements and bring them more into line with the facts, in this age of inflation, have surely some reason to think that things are gradually moving in the desired direction. The spring of this year saw the publication of "Changing Concepts of Business Income", a report by a committee comprising economists, lawyers and others besides accountants, so that it could not be regarded as speaking for any professional accounting body, though it was partly financed by the American Institute of Accountants. Yet its recommendation that companies whose stocks are widely held should be encouraged to give supplementary information as to income, in units of equal purchasing power, is an advance. And of special significance is the suggestion that this information be given, wherever practicable, "as part of the material upon which the independent accountant expresses his opinion". Following on this the latest publication from England, now to be reviewed, takes a positive attitude in favour of change, welcome indeed to the present reviewer.

"Accounting for Inflation" is a report by the Taxation and Research Committee

of The Association of Certified and Corporate Accountants and it is published for that Association. In a foreword to the book the Rt. Hon. Lord Latham, J.P., F.A.C.C.A., President of the Association, says: "There are, perhaps, intermediate stages of compromise and adjustment of practice and probably it is one of them that will provide an acceptable answer." He urges that this study will be worthwhile if it is found provocative and even iconoclastic, and readers will no doubt feel that these are worthy epithets for the treatise. But the significant thing is that these recommendations are those of a professional accounting body and as such they must be taken seriously.

The sub-committee primarily responsible for the research work consisted of five accountants and four economists, and the work of the latter is evident in the considerable economic content of the report. Indeed one of the happy features is the obviously close collaboration between accountants and economists. Techniques for new presentations of fixed assets and inventories in financial statements are worked out in detail, and the whole approach to the problems is positive, not negative.

As a preliminary the accountant's rule

of "cost or market whichever is lower" for the valuation of inventories is analyzed. This concept is seen as fusing two principles: (1) that valuation must be made at realizable value but (2) that unrealized profits should be "sterilized". Anticipation of inventory losses and ignoring of inventory profits, in times of falling and rising prices respectively, are reconciled with the basic rule by stating that the design of accounts should reveal the price change profit but prevent it from being distributed until realization. In an economic analysis of the question of inventory gains due to inflation, figures are quoted as evidence of the existence of long term cyclical movements of prices from peak to peak over periods of from 50 to 60 years. Within this long wave upswing are shorter waves, but the long wave is seen as evidence of the impossibility of arguing for most assets that under-provision for replacement under rising price levels is offset by over-provision when prices fall. The delay from upswing to downswing is far too long.

In contrast to the relative insignificance of price changes before World War I, when taxation rates were low, an index of 100 for fixed assets in the year 1938 is seen to compare with 232 in 1950 and a provisional 247 in 1951. For raw materials, finished goods and work in progress, respectively, the indices in 1951 are quoted as 648, 356 and 240. Figures obtained from a number of companies are said to "suggest that depreciation provisions in 1950 were approximately 50% deficient of the value required . . . on the basis of current replacement costs". Of particular interest is the committee's analysis of the profits of some 30 public companies of varying size, a "small but carefully balanced sample", for the years 1938, 1945, 1949 and 1950. On the assumption of the necessity for a further £20 million to be appropriated from profits in 1950 to

match the total of £20 million charged against that year's profits as depreciation, based on the estimated 50% deficiency quoted above, it would appear that the aggregate of £22 million actually appropriated by the companies to contingency reserves is almost wholly required for depreciation provision. The odd £2 million has "to cover appropriations for specific purposes, additional replacement costs of stocks, profit equalization, additional cash requirements, vital modernization and essential expansion". It is shown that actually there was an increase of £20 million in inventory values alone, probably due solely to inflation, and for financing this the stated £2 million was hopelessly inadequate. "The fact is slowly emerging", says the report, "that the sources of long-term capital available in the new issue market are gradually drying up", so that industry is becoming increasingly dependent on the aggregate of retained profits to finance new development. The position is, of course, much more serious in this respect in Britain than in Canada, which has a wealthy next door neighbour ever ready to finance its expanding industries.

The committee next proceeds to examine the orthodox accounting attitude: (1) accounting presentation must continue unchanged, (2) every effort must be made to obtain taxation relief. Adherence to historical cost is seen as based on two principles: (1) that financial statements do not record values, and that such bases as "cost or market values whichever lower" aim at expense allocation, not valuation; (2) the contract or risk principle, under-provision for depreciation during inflation being one of the risks accepted in doing business. The businessman's contract is that he will provide the income of the rest of the community in return for goods, and if he raises prices during inflation he is seen as breaking this contract. Orthodox accounting acts as though the businessman

had accepted this risk and the fiscal authority imposes acceptance for taxation, but in general the businessman rejects it. The committee's conclusion is that replacement cost accounting simply substitutes one risk for another, i.e. the risk of having capital losses, not to be allowed for income tax, during deflation, as against capital gains, which should not be taxed, during inflation.

After summarizing the views of noted economists, in a consideration of the replacement cost theory, the committee comes to its own proposals. It is to be noted that, in the English-speaking world, this is the first proposal by a professional accounting body for systematic conversion of historical accounts. For this reason the present publication is all the more significant. The committee's view is that the current cost of exhaustion of a fixed asset is the depletion in its current capital value resulting from current use. This depletion must be measured as the current cost of replacing the asset in the condition with which it commenced the period, and this charge must be made in determining true current operating profit. Income, as conventionally calculated, includes capital gains to the extent of the under-recovery of fixed asset costs and, if these are to be taxed, it should be done openly by a specific tax on capital gains. The committee proposes conversion of the historical accounts, illustrating the technique with the use of actual figures, including an asset revaluation reserve. This reserve arises from the increase of opening fixed asset values to their equivalent at the end of each period, and it is on this latter figure that the depreciation for the period is calculated and charged against the profits. An important point is made in regard to the likely excess of ultimate replacement cost, after a long period of inflation, over the accumulation in the reserve, due to the failure to provide for the effect of changing money values on

past accumulations. The deficiency is regarded as purely nominal, for it ignores the fact that the adequacy of financial cover for replacement will depend on how the retentions out of profit have been invested. The nominal deficiency only becomes real, says the committee, if (a) accumulated depreciation reserves are held in liquid form and (b) replacement over the whole range of assets is completely discontinuous, i.e. all assets have the same life and are scrapped and replaced simultaneously. This is extremely unlikely and the suggested technique is claimed as providing opportunity for exact replacement. The committee is right, therefore in warning that a technique designed to secure complete nominal coverage would actually result in much too large an accumulation and in understatement of annual profits. Similarly, in so far as the rate of exhaustion and replacement of inventories is uniform, exact accumulation of financial cover for replacement is assured if inventory profit, due to inflation, is withdrawn from the profit and loss account. This is the answer to the criticism that future costs of replacement cannot be properly forecast. The future cost does not require replacement now, only the current costs which have been absorbed in production during the period under review.

A technique is proposed for costing materials consumed and valuing residual inventories at current replacement values in each case, separating inventory profits and losses from current operating income. Both here and in the case of fixed assets it is to be noted that the possible use of actual replacement costs is envisaged or, alternatively, the employment of index numbers. Because the committee adopts the actual replacement cost approach the index numbers proposed are not indices of general purchasing power, as usually preferred, but specific indices for the particular assets. It is recommended that, in the published

profit and loss account, the total inventory profit or loss be separately reflected and that it be entered in the asset revaluation reserve on the balance sheet. In the balance sheet the opening position will be shown for comparison with that at the close, the two positions being reconciled in a separate statement setting out the changes in capital items. This capital reconciliation statement should have the status of the other two financial statements and be presented with them. This is presumably the committee's answer to the objection that departure from historical cost will vitiate comparison from year to year.

An appendix to the book discusses the situation in other countries — Germany, Belgium, France, Italy, Sweden, Denmark, and also the United States and Canada. The French system is consid-

ered the best actually in use, in spite of many shortcomings. It was initially received with misgiving but is said to have become increasingly popular. New enactments to bring the original law up to date have met with no violent opposition from accountants or economists, who have come to realize that the advantages outweigh the deficiencies.

If Canadian accountants read this book they will be introduced to many new aspects of a subject which must be giving them food for thought, and they will have a chance of studying practical accounting techniques in addition to sound theory. A select bibliography at the end will also lead them to other contributions to the subject which they may have missed. The result can hardly be anything but beneficial.

The Viewpoint of Quebec's Government

By Hon. J. Onesime Gagnon, P.C. (Can.), Q.C.
Minister of Finance, Province of Quebec

Quebec's Minister of Finance explains
the stand taken by his Government on several matters

IT is an honour and a privilege for me to address this afternoon the members of the Canadian Institute of Chartered Accountants and, on behalf of the Government of this Province, to extend a cordial welcome to them and to their guests from the British Isles and the United States. I congratulate you on the tremendous development of your calling which, after modest beginnings in England and Scotland, has gradually risen in importance as well as in the diversity of the services it renders to the community and has achieved the status of an independent profession as solidly established and highly regarded as medicine, the law, or the public service. How could we lawyers consider ourselves superior when we now admiringly contemplate the size and unmatched efficiency of your offices?

I warmly congratulate the Canadian Institute on having attained its 50th birthday and it is fitting that this important anniversary should be celebrated in this City since the Province of Quebec Institute, the oldest established in Canada, has now reached the 72nd year of its existence. The Cana-

dian and the Quebec Institutes have great achievements to their credit in fostering the aims of your profession and in instilling those high principles and rules of conduct which are an essential prerequisite of a calling which must be characterized by integrity, intelligence, industry, and insight, and I venture to think, having regard to our country's tremendous expansion, that those of you who will be meeting 50 years hence will look upon this convention as a small beginning indeed.

I am very sorry that our Prime Minister, the Honourable Maurice L. Duplessis, should have been prevented from addressing you on this important occasion: you all realize the greatness of his contribution to the expansion and well-being of this Province and I deeply regret that you should be deprived of the opportunity of listening to his witty remarks and of meditating on his constructive suggestions. We may appropriately apply to him, and to the times we are passing through, John Morley's appreciation of Richard Cobden: "Great economic and social forces flow with a tidal sweep over communities that are only half-conscious of that

Address delivered to the 50th annual meeting of the C.I.C.A., Quebec, Sept 8, 1952

which is befalling them. Wise statesmen are those who foresee what time is thus bringing, and endeavour to shape institutions and to mould one's thought and purpose in accordance with the change that is silently surrounding them." With us the change is, however, not silent. The evolution of our Province and the extension of progress in recent years has occurred in every department of our life, and it is a privilege for me to bear witness before this important gathering to the work which our Prime Minister is doing for the betterment not only of this Province but also of Canada as a whole.

Laval University's Centenary

It is a happy coincidence that a French Canadian, M. Emile Beauvais, should preside over your destinies at a time when your Institute is meeting in his native city as a tribute to Laval University which is celebrating this year the 100th anniversary of its foundation. Brigadier J. A. deLanne, whose French name recalls his ancestry in the Norman islands of the English Channel, has given tangible proofs of his love for McGill University by presiding over its "Alma Mater Fund" and collecting from graduates substantial sums of money for the maintenance and development of this ancient seat of learning. I am told that he has aspirations in another field and rumors have come to my ears to the effect that in certain contingencies, on which I do not feel called upon to dwell at greater length, he might possibly become Canadian Minister of Finance! Far from casting aspersions on the present federal administration which is faced with the highly delicate task of weighing re-armament necessities against taxation possibilities, I venture to think that a fresh outlook might possibly bring about that reduction of federal taxation to which we all as-

pire. Perhaps I am too bold in saying *all* and I wonder whether I should not exclude chartered accountants whose ample income does not suffer too much from the present high rates and complications of corporate taxation!

The Profession's Contribution to Public Administration

The Cabinet of the Province of Quebec proudly counts as one of its senior members an outstanding member of your profession, Hon. Paul Beaulieu, C.A., to whom in 1944 our Premier entrusted the highly important post of Minister of Trade and Commerce. The industrial development of our Province over the last eight years may, in no small degree, be ascribed to the dynamic personality of Mr. Beaulieu who, during the course of numerous missions at home, in the United States and abroad, has repeatedly drawn the attention of leading industrialists to the limitless possibilities of the Province of Quebec.

Seated on my left is my friend Rosaire Courtois whom I proudly hail as a graduate not only of the Montreal School of Higher Commercial Studies but also of the Province of Quebec Finance Department, where his insight and understanding of public finance brought about salutary reforms and worth-while innovations. Mr. Courtois' wise counsels gradually led to the adoption in our Province of the principle of balancing our budget on an over-all basis, or, in other words, of meeting out of revenues not only ordinary expenditures but also capital expenditures which, in other jurisdictions, are to a large extent defrayed out of loans. This policy is now so firmly entrenched in our financial structure that for the sixth time in the last seven years of our administration, the fiscal year just closed showed an

over-all surplus, a surplus which for that particular period amounted to \$1,812,169.02.

* * *

I have followed with much interest various undertakings of your Institute which have direct bearings on public finance: I thank you for the co-operation you have extended to the conferences on provincial financial statistics, by delegating some of your members to advise on the requirements of what is called, in technical jargon, the "consumer public". While government accounts must primarily fulfil the requirements of the Legislatures to which they are submitted, these accounts are actually most widely used by the banks, investment houses and chartered accountants and, in this field, as in all others, we must at all cost avoid overlooking the needs of the "consumer". I hope that as the result of our combined endeavours we may gradually and in time achieve the objective which you describe as "a feasible degree of uniformity in government accounts and accounting procedures".

Federal-Provincial Relations: Quebec's Position

But of much greater importance was the setting up of the Canadian Tax Foundation by the joint action of your Institute and of the Canadian Bar Association, and I think that I should take advantage of this unique opportunity to refer to the attitude of the Province of Quebec towards federal-provincial relations in the field of taxation.

Briefly, we are opposed to the system of grants and subsidies paid by one government to another and we firmly hold that the solution to present-day difficulties lies in what the 1951 brief of the Canadian Chamber of Commerce described as "a clean-up of Dominion-provincial taxation arrange-

ments, to make a clear definition of federal and provincial taxation fields".

I believe it is opportune that I should now insist on the cogency of certain statements made by Sir Wilfrid Laurier and the Right Honourable W. L. Mackenzie King. Thus, in the speech which he delivered in Somerset, on August 2, 1887, a few days after his appointment as Leader of the Liberal party, Sir Wilfrid Laurier declared:

It is a completely false principle that one government should impose the taxes and another government spend them. This will always lead to extravagance . . .

A little later, at the time when Honoré Mercier was on the point of summoning an inter-provincial conference, Sir Wilfrid warned Mercier against the dangers of asking for increased federal grants and added these very significant words:

Consequently they (the subsidies) have on several occasions been augmented and these successive augmentations, made without any regard to rule, constitute in reality a system of corruption in the hands of the federal government and have been too often used by it to reward political treachery.

The Right Honourable William L. MacKenzie King, made the following statement in the House of Commons in 1930:

When on a previous occasion we were discussing this matter of grants from one treasury to another, I said I thought it was an unsound principle; in fact, I think I used the expression that it was a vicious principle to have one body raise the taxes and another body spend the people's money thus raised.

Quebec's Unvarying Point of View

The unvarying point of view of the Government of Quebec was succinctly expressed in the following passage of the memorandum submitted on April 25, 1946 to the federal-provincial con-

ference by our Prime Minister, Maurice Duplessis:

It is one of the essential prerogatives of sovereign states that they may raise by taxation, in the manner that they deem most appropriate, the sums necessary for the efficient working of the public services and the carrying out of the laws enacted by their Parliament, not only with a view to present requirements but also with a view to the future. The federal system which involves an allocation of public powers among the several federated states must also involve a corresponding apportionment of the sources of revenue. What use could Provinces make of the most extensive legislative powers if, on the other hand, they were prevented from raising the funds necessary for the exercise of those powers? A central government which appropriated to itself all the sources of taxation would, in fact, reduce the Provinces to legislative impotence. It is clear that a Province collecting no revenue other than the subsidies granted to it by the central state would cease to be a sovereign state and would become a sort of subordinate governmental body under the tutelage of the authority from which it drew its means of subsistence. Under the *British North America Act* the Provinces have the exclusive power of legislating in extremely important matters, particularly education, municipal institutions, public works within the Province, hospitals, asylums and charitable institutions, the administration of justice and more generally, all matters concerning property and civil law. All these matters are of fundamental importance and progressive legislation in these various spheres involves considerable expenses and evidently implies for the Provinces, the power to raise the sums necessary for those purposes.

Quoting from an article by Mr. Hatton W. Summers of Texas, who was chairman of the important Judicial Committee of the House of Representatives at Washington, the memorandum went on to say:

By making the units of state govern-

ment financially dependent on the federal government, that government is acquiring the power to control the units of state government. When this is fully consummated, the sovereignty of the state governments will be liquidated . . .

In weakening the states we weaken the whole fabric of free government. The inescapable price of free government is that we exercise it. The most destructive force in the world is non-use. If we do not use powers of self-government in the states we will awake one day to find that self-government has passed irrevocably out of our hands.

Government is exercised best in the local community. There the problems are perceived with greater clarity because they are close to the people and on a scale within their grasp. The self-reliance of the individual, town and state is being destroyed as they are being relieved of the necessity of governing themselves. When people stop thinking for themselves there is always someone willing to step forward and do their thinking for them . . .

Nature has not endowed any group of human beings with the sweep and grasp of intelligence necessary to handle the multitude of federal and local problems dumped upon Washington . . .

And the memorandum concluded:

It is the opinion of the Government of the Province of Quebec that the country's needs are threefold: the clarification and precise delimitation of the taxing powers of the Federal and provincial governments in accordance with the spirit and the letter of the Canadian constitution, that is to say, keeping in mind the past, the present, and the future.

Secondly, the simplification of public taxation in order to lessen its cost and facilitate its collection.

Thirdly, the co-operation of all powers to achieve moderation in the field of taxation and to lighten the burden imposed upon that eternally forgotten man: the taxpayer.

Strict Delimitation

of Taxing Powers Essential

The delimitation of the fields of tax-

ation as between the federal government, the Provinces and the municipalities in strict conformity with the basic provisions of the *British North America Act* has been the focal point of Premier Duplessis' urgent and repeated demands at all the conferences held since 1946. The Province of Quebec, which merely asks for the continued enjoyment of the rights assigned to it by our Constitution, is opposed to all forms of centralization and particularly that under which the federal government collects 76.7% of the taxes — as against 51.2% in 1939 — leaving to the Province only 12.5% and the municipalities a paltry 10.8%.

The logical, consistent, basic position of the Province of Quebec is that the arrangements concluded between the federal government and the other Provinces are merely temporary make-shifts which tend to aggravate the present constitutional difficulties and to delay their solution. Neither does our Province share the belief expressed by certain bureaucrats that these arrangements have the effect of lightening the taxpayers' burdens: as our Prime Minister has frequently pointed out, the state does not create wealth, it merely redistributes the revenue which it collects from its citizens and we further consider that lump-sum grants engender administrative waste and inefficiency.

The creation of appetites by federal bureaucrats and the continuous invasion, by way of grants or otherwise, of the jurisdiction exclusively assigned to the provinces by the B.N.A. Act are not conducive to the unity and prosperity of Canada. We therefore conclude that fiscal and constitutional security will only be assured by the precise delimitation of the fields of taxation as between the three principal levels of government.

Integrity of Federal Structure Vital

In a remarkable leading article published on September 4, *L'Action Catholique* of Quebec City stressed that the Provinces were yielding to the federal government's blandishments because they had not set up a united front and suggested that the Province of Quebec should take the initiative of calling a conference of all the Provinces, or at least of undertaking negotiations starting with those Provinces which had reluctantly accepted the federal government's proposals. The article concluded as follows:

It must not be forgotten (says Mr. Charles Pelletier in the above-mentioned article) as was stressed by the Honourable Ernest Lapointe, that it was the Provinces' action which created the federal state. In so doing they did not intend to give themselves a master who would rule them with a rod of iron but they desired to entrust the central government with the care of settling problems of common interest and of external policy, without interfering in the internal affairs of each Province and without monopolizing all the sources of revenue for its own purposes.

If the Province of Quebec, at the cost of certain financial sacrifices and of many efforts, thus succeeds in saving the federal system, it would thereby render Canada as a whole a tremendous service inasmuch as, in a country as vast and as diversified as ours, this system is the only one which is compatible with genuine democracy.

Such would be the supreme aim of Quebec policy in the realm of Canadian inter-governmental relations and this policy has the greater chances of success if it is —as certain declarations made during the last electoral campaign lead us to hope—not the policy of a single party but of the whole Province: a genuine bi-partisan policy, the expression of a common aspiration centered on the permanent and highest interests of our Quebec community and of the whole country.

I presume you have read the import-

ant editorial which *The Montreal Gazette* has just published [September 8, 1952] under the caption "A Separating Policy":

If a federal system is really to have soundness, it is essential that some proper division be made of the fields of taxation. In this way both the federal and provincial authorities would have the security and independence of resting upon their own ground and tilling, as it were, their own fields.

We therefore venture to hope that the Canadian Tax Foundation recognizes the validity of our position and that as the result of its recommendations progress will be achieved in the realm of inter-governmental financial relations and that the present-day excesses of direct taxation which stifle private initiative and hinder progress will be eradicated. We obviously realize the difficulties with which the central government is faced as the result of the burden of past and, unfortunately, of possible future wars, but we urge that the burden of the taxpayer be also considered. You heard of the case of Sir Alfred Munnings, past president of the Royal Academy, who recently refused to paint the picture of the Aga Khan's Derby winner, since having regard to several previous commissions, the tax and surtax would have swallowed almost the whole of his fee. Let us not in Canada carry taxation to such absurd extremes!

* * *

Laval University's Program of Expansion

We are celebrating this year the one-hundredth anniversary of the foundation, by Royal Charter and Papal Bull, of Laval University: its existence can be traced back to a much earlier period since its cradle was the Séminaire de Québec founded by Archbishop Laval in 1663, the ancient buildings of which

imposingly overlook the St. Lawrence River widening at the bottom of a towering cliff, between Quebec, Levis, and the Island of Orleans and, further afield, the undulating range of the Laurentian Mountains. To mark this important date in the annals of education and culture in the Province of Quebec, numerous conventions have been held in this city in the past summer and I am happy that you too should have decided to meet here this year.

To provide for the tremendous growth of the university and for future expansion, 640 acres of land were acquired on the western fringe of the city; part of the proceeds of a \$10 million financial campaign and of generous grants by the Provincial Government were appropriated to purchase and landscape the new campus and to provide the necessary services. Two buildings have so far been erected: the School of Forestry and the School of Commerce. Thanks particularly to the efforts of a committee of Quebec businessmen, one of the principal officers of which is a leading member of your profession in this city, a most up-to-date building has been provided for the School of Commerce which every year trains a number of future chartered accountants and the enrolment of which last year totalled 290 full-time and 515 part-time students. May I in passing refer to the school's accomplishments in recent years: a first and a second place in your Institute's examinations for the whole of Canada and three second places for the Province of Quebec examinations.

These two new constructions are but the beginning of greater things to come and I feel confident that, when you next meet in Quebec, we shall be able to take you around the new Seminary, the new Faculty of Medicine, and many other buildings.

Quebec's Dual Educational System

In an address which he delivered at Oxford University, Sir Robert Borden, former Prime Minister of Canada, stated that:

The qualities of the French and English temperaments are in many respects complementary. Each is capable of distinctive service to the state and each has given it. Not in fusion, but through co-operation, the highest service of the two races can best be given to Canada. . . .

We believe that this co-operation in diversity was promoted by the unique dual system of education of the Province of Quebec which dates back to just over 100 years ago. Side by side, without one system interfering with the other, Catholic and Protestant children are educated in state schools which operate under the direction either of the Catholic or of the Protestant Committee of the Council of Education, both Committees being placed under the general authority of the Provincial Cabinet.

Time does not allow me to dwell at greater length on the detailed features of this scheme which has completely eradicated such frictions as arose in the early days of Lower Canada and as still exist in certain parts of this country of ours, but I thought that you would be interested to hear of this distinctive contribution of the Province of Quebec to the solution of a problem which has been the source of many difficulties in countries inhabited by people of different racial and religious backgrounds.

In your particular field, the Government of the Province of Quebec fosters the education of future chartered accountants not only at the Laval School of Commerce but also at the School of Higher Commercial Studies at Montreal which had in 1950-51 an enrolment of 928 day and night students. Over 360 of its graduates have become chartered

accountants. In the same year 602 full-time students were registered at the McGill School of Commerce and 1226 attended evening courses there for the Accountancy Diploma. I need not add that many other schools, scattered throughout the Province, give instruction in accountancy at various levels.

The Government of the Province of Quebec has proved by its record, particularly over the last eight years, that it is keenly alive to the problems and requirements of education to which it devotes over \$45 million yearly and, reverting to your particular field, I may say that when you are looking for promising students to staff your offices you may with confidence apply to any of our universities and schools of commerce.

* * *

French-Canadian Chartered Accountants

C'est avec beaucoup de joie que je salue la présence dans cette salle d'un nombre si imposant de comptables agréés canadiens-français. Lorsque j'étudiais le droit avant la première guerre mondiale c'était presque sur les doigts d'une main que l'on pouvait compter les canadiens-français qui appartenait à cette importante profession alors que, depuis de nombreuses années déjà, notre race fournit la grande majorité des avocats et des notaires québécois. Les temps ont bien changé et je me réjouis de constater l'apport de plus en plus important de nos compatriotes au développement des affaires et de l'industrie de notre province qui connaît depuis le début du siècle et particulièrement en les dix dernières années, un si magnifique essor.

Cette extension de la profession parmi les nôtres a été grandement facilitée par les sages mesures prises par notre gouvernement provincial lequel, reconnaissant certaines lacunes qui existaient au début du siècle,

fondait en 1908 l'Ecole des Hautes Etudes Commerciales de Montréal dont 362 diplômés ont obtenu le grade de comptable agréé et 282 exercent leur profession en leur qualité de membres de votre Institut.

Government Support

Les subventions à l'Ecole qui en 1909-10 s'élevaient à \$30,000 ont été graduellement portées à la somme de \$275,000 qui figure au budget du présent exercice et les résultats obtenus ont dépassé toutes les attentes puisque les bâtiments actuels sont devenus trop exigus pour les 928 élèves des cours du jour et du soir et que leur reconstruction pose des problèmes qui n'échappent pas à notre attention.

Il en est de même pour l'Ecole de Commerce de Québec à laquelle le gouvernement accordait en 1951 un subside de \$600,000 payé comptant et le mois dernier aux fins de la construction de son édifice une subvention exceptionnelle de \$1,500,000, en plus de l'octroi annuel qui a été porté à \$30,000 depuis quelques années. J'ai été heureux d'apprendre que vous aurez l'occasion de visiter le magnifique nouveau bâtiment de cette école à la Cité Universitaire, bâtiment qui sera officiellement inauguré le mois prochain.

Une quarantaine de vos confrères sont employés par le gouvernement de la Province de Québec et, pour ma part, je m'efforce de rehausser le niveau intellectuel et moral de nos fonction-

naires en augmentant progressivement le nombre des diplômés d'universités et de membres d'associations professionnelles comme la vôtre.

Canada's Great Future

Mettez-vous à ma place et comparez la situation des jeunes en cette année de grâce 1952 avec ce qu'elle était il y a quarante ou cinquante ans: les deux industries actuellement les plus importantes pour notre économie celles du papier et de la génération d'électricité étaient virtuellement inexistantes, l'industrie textile en était à ses débuts, le Royaume du Saguenay vivait des produits d'une agriculture naissante, nos mines d'or étaient inconnues et l'on ne se doutait même pas de l'existence de nos immenses gisements de fer!

Par compensation, nous jouissions d'une situation internationale beaucoup moins inquiétante et l'on pouvait croire à l'élimination prochaine des guerres ainsi qu'à une évolution constamment dirigée vers le progrès de l'humanité.

Mais quelles que soient les incertitudes de l'heure et les angoisses qui pèsent sur l'avenir du monde menacé de perpétuelles crises économiques et politiques, je vous envie vous les jeunes qui bénéficiez de l'avantage insigne d'avoir pour patrie ce Canada dont nous sommes tous si fiers et je vous souhaite la plus franche réussite dans une profession qui contribue si grandement à l'essor de notre province et de notre pays.

A Banker Looks at An Auditor's Report

By F. A. R. James
Inspector, Royal Bank of Canada

What would a banker like to find in an auditor's report?

A PART from call loans, loans to provincial governments and municipalities — totalling \$270 million — Canadian banks are financing corporations and individuals in industrial and commercial activities to the extent of nearly \$3 billion. It is true that other factors enter the picture such as character, experience, and ability of the borrower, and that to some extent loans may be independently protected by readily marketable securities, but I think the major part of the total I just mentioned represents financing against the balance sheet position of the borrowers involved. One can see, therefore, the tremendous responsibility carried by the auditing profession to both shareholders and bankers, and I might add that the presentation of a company's position by way of the balance sheet and the dependence placed on the certificate of the auditors have much to do with making this very substantial amount of financing possible.

To emphasize the reliance which the banker places upon the auditor's report, I might mention that even with concerns of modest size, the banker not only encourages them to employ the services of chartered accountants but frequently insists upon their doing so.

What, then, does the banker look for in an auditor's report or, perhaps, what would he like to find? So far as most large corporations are concerned, information required by the bank is readily available as a rule from the comptroller or some other executive officer, and in my remarks I propose to deal with the subject more as it applies to those not coming within that category. In few cases is an auditor's report an up-to-date statement of the financial condition since, generally, it is impossible for him to complete his duties and submit his report within a matter of days of the closing of the concern's financial period, but it is an accurate portrayal of the situation as it existed on a certain day and, in many respects, a review of the client's operations through the year.

The banker invariably compares the figures with those for the previous year or years; in fact, banks have their own printed forms on which the balance sheet figures are transcribed under their appropriate headings and on which are set forth the comparable figures for the preceding year or years. One of the first things he looks for is the explanation of changes in working capital. It is reassuring to look at an operating state-

An address to a luncheon meeting of the Manitoba Institute, Nov. 5, 1952, Winnipeg

ment and see a profit, but it is important to see how the latter has been used as well as to determine what has been done with the capital generally. With certain exceptions, the working capital provided by the business has a bearing on the extent to which the bank is prepared to extend credit and, according to the type of business, often there is a limit to the volume of business which can be undertaken successfully on that working capital. In some cases items contributing to the change in working capital position are tabulated and commented upon in the auditor's report, but in many no mention of these items is made.

Inventory

Inventory is one of the most important items and of particular interest to the banker. In the case of a manufacturing concern, what proportion of the inventory represents raw materials and what do they comprise? What percentage represents work in progress and to what extent are finished goods included?

Generally, a banker is very much in his customer's hands so far as inventory figures are concerned, and the question of character and integrity is of the highest importance. A banker must be on his guard against omnibus items such as "stock and work in progress" or "stocks of raw materials, finished goods, etc." It is realized that the auditor is not an appraiser and must accept both the taking and valuing of stock of all kinds by the company's expert, and that this is particularly true where work in progress is concerned, but it would be helpful if, according to the nature of the business, a breakdown of the inventory could be given to cover items such as:

- (a) raw materials;
- (b) bought-in components;
- (c) work in progress;
- (d) completed and salable stock;

(e) crates, containers and packaging materials;

(f) factory supplies such as fuel, etc.;

(g) by-products;

and commented upon in respect to any particular features which come to the auditor's attention.

If inventory is not well balanced it can lead to trouble. If any one item of consequence is out of proportion, the cost of carrying it can become a serious factor in the ultimate cost price of the finished article, while at the same time expose the company to loss in the event of a decline in prices. Again, it is unhealthy for a company to have too large a part of its working capital tied up in any one line. I recall a case not long ago of a concern which manufactures various lines, some for sale the year round, others seasonal. The balance sheet position looked fairly healthy except that inventory was somewhat high in relation to turnover. It was not long afterwards that the turnover in the bank account indicated that sales were sagging. It transpired that operating losses were showing because fixed charges and other expenses were geared to a higher turnover. The explanation was that the major portion of the inventory, because of unwarranted buying, related to seasonal production and could not be moved for another six months, while in the meantime the company lacked funds to purchase the materials and to cover the cost of manufacturing them to provide for the year round sales. The situation which had existed at the year-end caused concern to the bank, but no mention of it had been made in the auditor's report.

When looking at inventory figures, the banker also takes into consideration the net sales and determines the turnover ratio. This is only a simple arithmetical ratio and is not conclusive, but, when placed beside the comparable figure for previous years, can give rise to questions.

If it is out of line it can be a danger signal, indicating obsolete or slow moving lines, or, again, stress due to over-buying. Not too long ago a successful businessman left at the bank his firm's annual report, of which obviously he was proud and, in many respects, justifiably so. A few days later when he called to discuss the bank credit he would require, mention was made of the heavy inventory and he proceeded to say how he had been buying at very favourable prices, particularly having in mind the supply situation. When it was pointed out to him that his turnover ratio had declined from an average of X% to Y%, and that his situation could be vulnerable, he immediately took steps to rectify it. He had been so close to the scene that he had not stepped back to look at the over-all picture.

The banker also considers inventory in relation to working capital and to net worth, since experience has proven that extreme care should be exercised if, according to the type of business, inventory is too heavy in relation to the items mentioned notwithstanding that the ratio of net sales to inventory seems in satisfactory relationship. The relationship between inventory and current debt also is of interest, and a high ratio in many cases indicates the need for additional capital or a policy of restricting sales.

Accounts Receivable

It is not difficult to manufacture goods nor to sell them, but it is important that they be sold to concerns or individuals who are prompt in payment. The regular income, that is the collectibility of its sales, is the very life blood of the business enterprise. Sometimes the auditor's comments are such as:

Accounts receivable \$..... No allowance for doubtful accounts is carried on the company's records. All accounts considered by the management to be uncollectible as at were

charged directly to profit and loss. We did not communicate with the debtors to confirm the amounts shown to be due from them.

Yet the quality of those remaining on the books all too frequently is not commented upon. In many cases the banker would like to see them classified as to age, say, 30/60/90 days, etc. It is true that the picture may have changed before the report reaches the bank, but, nevertheless, it raises a point which would be followed up by the banker and, presumably, the customer. Financing receivables is an important phase of banking and it is not unusual for the bank to ask periodically for a list of the larger items. The same name may recur regularly but, if the amount varies, it might be thought to indicate turnover rather than slowness. The age classification may indicate the credit policy followed by the customer, and, in turn, the calibre of his accounts. While certain debts may be collectible over a period, it is not healthy for the bank or its client to have the latter's line of credit clogged by slow accounts. If the latter involve any amount of consequence, they can easily influence the success of the business. I think the classification would be of major interest to the management of a business, particularly where financial matters are left to any extent to a subordinate.

The banker also looks at receivables in relation to sales and figures the average collection period. Except when it is necessary to allow for larger than usual year-end receivables due to recent sales, this figure should be in fair proportion to the net selling terms of the business, and when compared with similar figures for previous years can be very interesting. Some variation may be expected according to general conditions prevailing, but any change of consequence warrants investigation on the part of the banker and of the customer. I remember a client was asked his experience with respect to

collections and, without reservation, he stated they were exceedingly good. A few days later we received and examined his audited statement. When we mentioned to him that it indicated his average collection period had moved up from "X" days to "Y" days, he decided that his previous comments were somewhat optimistic and returned to his office to carefully review his receivable ledger.

The banker would appreciate, also, if the auditor's comments made reference to any other unusual features. I have in mind that when we enquired closely into one company's receivables, which were very wide-spread, we questioned a number of the risks and were then informed the company fully appreciated that they were following a lenient policy in relation thereto, but that they were not apprehensive as to the eventual outcome since they held security by way of chattel mortgage on various assets of the customers involved. Obviously, for banking purposes such accounts could not be considered as current and readily realizable, but no mention of this feature appeared in the auditor's report.

The banker would like, also, to see a breakdown of accounts due by shareholders, officers, etc., and similarly, on the liability side, of amounts due to such individuals.

Investments

Investments cannot be appraised as to value unless details are available, and the banker likes to see the latter either in the balance sheet or in a separate schedule.

Accounts Payable

When examining a balance sheet, a banker and, I presume, many others, often will look first at the liabilities and then to see what assets are held to provide for the debts. A leading question often asked by the banker is:

"How do you stand with the trade; are any accounts pressing?" Bank credit is available for various purposes, principally to finance receivables and to assist a company in the purchase of their requirements of raw materials. Accordingly we are always very interested in the total of liabilities to the trade in relation to bank loans, inventory and receivables. I think it hardly necessary to mention that not always is bank credit used for the purpose intended, and this is something that we as bankers have to watch very closely. Naturally we would not care to make a generous total of credit available and find that the company's trade liabilities were being maintained at an unreasonably high level. A schedule of trade payables, indicating the portions current and overdue, would be of much benefit, and it is not inconceivable that such information if brought to our attention in this manner would enable us to take early steps to check a deterioration in their position which, if allowed to continue, might result disastrously. Another feature which such a list can disclose when put alongside a list of the receivables, is the fact that some names may appear both as creditors and debtors. As you can realize, it is very disconcerting to a banker relying upon receivables to find himself confronted with an asset reduced by offsets.

Income Taxes

Income taxes are one of the major problems of today and engage considerable of the auditor's time. In many cases interpretation of the Act may be involved and, since opinions differ, that of the tax official is not always known until some time later. The balance sheet shows the liability for taxes, but just what period that covers is not always indicated. One thing the banker would like to know is the

date to which his client's income has been assessed by the Income Tax Department, and if all tax liabilities to that date have been paid.

Fixed Assets

Land, buildings, machinery and equipment, etc., usually are shown at cost with the reserve for depreciation, and in many instances the banker would appreciate it if, included in the report, was a schedule from which could be followed the additions and disposals during the year. One of the points invariably discussed when reviewing a company's credit requirements is the question of capital expenditures contemplated, but there are times when the latter are undertaken without reference to the bank. Such a schedule, therefore, does help a banker to some extent to keep track of the nature of the capital expenditures made.

Fixed assets not infrequently are subject to charge in connection with mortgages or lien agreements, and the debt shown as a deferred liability. The banker is interested in knowing the extent to which assets are charged, in whose favour the debt is registered, and how it is payable; if payments are up-to-date, and if that part of the debt maturing within the ensuing 12 months has been included in current liabilities.

Insurance

Insurance is a matter of great interest and importance. The banker's loans must be safe, liquid and profitable. A loan which might be so regarded could assume other aspects in the event of a serious loss or interruption due to fire. In many instances, of course, particularly where loans are directly related to inventory or goods in storage, the bank will require as security policies covering the risk, with

loss if any payable to the bank. There are cases, however, such as when loans are of a revolving nature for general purposes that security by way of insurance is not stipulated and reliance is placed upon the customer's word as to his coverage. Obviously, if in the event of some disaster the customer is faced with making capital expenditures for which he has not the necessary liquid resources, continuation of his business might be in jeopardy. The banker would likely recover his loan but might well lose a good customer. Insurance requires to be reviewed frequently since it is the easiest thing in the world for a man busy with many phases of his company's business, to overlook this essential protection, and so many even in a large way of business fail to realize the impact of the co-insurance clause if they suffer only a partial loss and are underinsured. For these reasons the banker would like to see the coverage scheduled and, where appropriate, commented upon in the auditor's report.

Turning to the operating statement, the banker again uses previous years for comparison. In many cases he figures the major items on a percentage basis, as often in this way he can get a better picture of the operations. This is important where the customer is leaning on the bank to any extent. As you know, the trend recently in many lines has been towards lower profits, that is, where sales have remained fairly constant because of the inability to pass along the higher cost of operations, particularly wages. First of all, the percentage of gross profit gives an indication of efficiency, since in most cases selling prices are governed by competition. Major cost and expense items, including labour, expressed percentage-wise, when placed beside comparable figures for previous years, will often bring into view more prominent-

ly features which require adjusting if the company is to continue to operate satisfactorily.

Conclusion

I have mentioned a number of features with which the banker is concerned. It seems to me that what is of interest to the bank should be of equal interest to the customer, and yet I feel that all too frequently the latter does not derive the benefit he should from the auditor's report. Many seem to regard it as a necessary formality to comply with the requirements of the Director of Taxation and the bank. I have often wondered if it might not benefit all concerned if

things such as I have mentioned today were given greater prominence in reports submitted by auditors. After all, it is of major concern to both auditor and banker that their customers maintain a sound position in business. I feel certain that if some or all of the features I have highlighted were projected in greater detail in the relative report it would go a long way toward ensuring the successful continued operation of the business concerned, and if the auditor and banker lost a customer through inexperience or bad management it would not be because he was not forewarned by a presentation of the exact situation of every phase of his business.

Letters from Readers

312 High Street,
Northcote,
Victoria, Australia.

EXCHANGE OF PERIODICALS

Sir: I am writing to you in the hope that you may know of a young chartered accountant who would be interested in receiving current accounting literature from this country. In return, I would appreciate his placing my name on the circulation list of your journal.

This is perhaps an unusual course to adopt, but the current artificial exchange rates operating between the dollar and sterling areas mean that a considerable sum of Australian currency is involved in receiving, through direct subscriptions, any variety of international accounting literature.

I was recently admitted to the Commonwealth Institute of Accountants and the Australasian Institute of Cost Accountants. The periodicals which I shall be pleased to order on behalf of the Canadian C.A. are *The Australian Accountant* and bulletins of the Cost Institute.

JOHN O. MILLER

Montreal, Sept. 27, 1952

MORE ON RECRUITMENT

Sir: Because of a lengthy out-of-town business trip, I have only recently finished reading the June 1952 issue of your magazine. Amazement and astonishment move me to reply to the letter of Mr. Jean Latour, C.A. which appeared in that issue. His letter indicates a misunderstanding of a serious problem.

We are all concerned about the difficulty in attracting young people as juniors in our profession. For a practising member to give the impression that he fears competition from these future chartered accountants would indicate lack of confidence in his own ability.

At no time has any suggestion been made that more articles be written *about* students. The suggestion has been made that more articles *of interest to* students be included in the magazine. At the same time, these articles would be of interest to chartered accountants desirous of keeping abreast with the latest developments concerning the complexities affecting and the increasing demands being made upon our profession.

There need be little fear about *The Canadian Chartered Accountant* turning into "half-professional and half-student". A truly professional magazine constantly keeps in mind the interests of the profession in attracting young people to its ranks. One way to accomplish this is to include amongst its pages articles which will contribute to the young aspirant's knowledge and thus help him reach his goal. I agree that it is not the purpose of this magazine to *train* students to *write* exams. However, it is the purpose of this magazine to *help* students *pass* exams.

The responsibility for training students to write exams rests with the universities. But due to the lack of proper instructional staff, this has not been effectively fulfilled. In addition, indentured students are not receiving the supervision nor the experience at work which would enable them to gain the ability about which Mr. Latour and other thinking chartered accountants are so greatly concerned. If a university is only as good as its students (as Mr. Latour would have us believe) then it is time that the universities hurried up and did something about it.

I am anxious to learn the source of the statistics which state that if 50% fail, 50% must have passed. It does not require advanced mathematics to arrive at such a conclusion. If this ratio were correct, and I

venture to say it is not, then Mr. Latour and myself would have little disagreement. True, the examinations are not impossible. But the conditions under which they are written are nearly so.

No one asks for a lowering of standards. On the contrary, a raising of standards of instruction is demanded. I wholeheartedly agree that there are incapable persons sitting for the final exams. That is not their fault but a weakness of a system which permits these students to advance to the final level, though not being of that calibre. The major task of elimination, if any, should not take place in the final years, but rather in the earlier years. Entrance standards should be raised (along with starting salaries) and thus attract a higher calibre of student. At the same time, standards of instruction and marking should be raised at the intermediate level. Thus, by the time a student reaches his final years, the odds will be in his favour that he has what it takes to pass the final examinations and make his contribution to our growing profession.

However, this is only part of the problem. The matter of low salaries, poor university instruction, and lack of coordination between the Institutes, employers and employee-students constitute the major difficulties to be overcome in attracting new entrants to our profession as well as giving a much better deal to present indentured students.

P. F. MARKET, M.Com.

Recent Books

U.S. Taxation of Foreign Entities, by Neil F. Phillips, B.A., B.C.L., LL.B.; published by The Carswell Co. Ltd., Toronto; pp. 360 and index; price \$8.50

The sheer labour required to accumulate, digest, arrange, inter-relate, in short to man-handle the mass of statutory provisions, regulations, judicial decisions, bulletins, rulings, memoranda, opinions, and so on relating to any branch of the United States income tax behemoth is a source of wonder and dismay to this Canadian at least. Few indeed are those of us who would venture to speak authoritatively on even the simplest feature of the United States Internal Revenue Code. Among those must certainly be counted Mr. Neil Phillips of Montreal. The Canadian practitioner who makes use of this book will be able to offer a client who is about to venture south of the line or who has business interests there detailed and specific advice which, until now, has been hidden away in the underbrush of those gargantuan American tax services.

The valuable feature of this book is that it contains propositions and discussions of the law which make it a text and not merely a storehouse of references. The Table of Contents taken in conjunction with a very complete index quickly directs attention to concise and lucid comment.

Reading the book, a Canadian is struck by a conspicuous point of difference between the United States and the Canadian scheme of income taxation.

For us the element of foreignness or alienness and conversely of citizenship has no significance. If you reside in Canada, work in Canada or do business in Canada you pay tax. If you do none of these things but draw certain kinds of income out of Canada you pay tax. If you do not like Canadian tax laws it is quite all right to move off with your family and belongings and whatever part of your fortune is detachable to some happier climate. Not so, apparently, to the south of us. It is the inalienable privilege of all red-blooded American citizens around the face of the globe to pay taxes to the Commission of Internal Revenue in Washington, D.C. As a basis for taxation it is fundamentally different from that to which we are accustomed, and, as Mr. Phillips' book indicates by its size, adds tremendously to the complexity of the law.

The first four chapters comprise the bulk of the book and are headed respectively The Framework of the Law, Factors Determining the Nature of the Taxpayer, Factors Determining the Income to be Taxed, and Factors Determining When the Income Tax is Due. The remaining two chapters have to do with special classes of taxpayers such as partnerships, trusts and foreign personal holding companies and the conventions which have been entered into between the United States and some ten other countries including, of course, the Canadian treaty. The broad chapter headings are broken down into sub-headings which provide direct access to the particular problem. The discussions

in chapter two of what criteria determine whether an individual is or is not a United States citizen and whether an alien is or is not resident in the United States are particularly useful.

STUART THOM, LL.B.
Toronto, Ontario

The Taxation of Corporate Income in Canada, by J. Richards Petrie; published by The University of Toronto Press; pp. 373 and index; price \$7.00

Dr. Petrie's volume is a welcome addition to that field of taxation literature dealing with the history and philosophy of taxation in Canada. The theme is the double taxation arising when corporate income taxes are imposed concurrently with separate personal income taxes without basic integration.

The author's purpose is to propound the objectives of a sound income tax policy, to review appropriate methods to attain such objective, to assess Canadian tax legislation in the light of the ideal criteria, and to suggest possible means by which Canadian law and practice may be reconstituted to achieve desirable results.

The magnitude of the task is a little overwhelming for a volume of 342 pages and the reader develops an ever-increasing respect for the author's ability as the story unfolds. The organization, selection and use of the end-products of an apparently exhaustive research are orderly and the author has skilfully reduced to a short space the endless permutations and combinations which arise from the interplay of the legal, accounting, economic, and political aspects of income taxation.

As the viewpoint is that of the economist, concentrated attention must be given to the sequence of the argument but at the same time it is difficult for the reader to keep out of the argument itself. The ramifications of thought arising from the narrative, if recorded, would increase the size of the work many times.

The methods of presentation from time to time are those of the discussion group leader, the professor in class, the counsel for the prosecution, and the research scientist, which adds interest and variety.

Despite the immensity of the problem Dr. Petrie has attempted to give a fair hearing to all sides of the question but nevertheless proceeds to positive conclusions. If the author were less fair in examining the pros and cons his conclusions would leave less room to doubt the infallibility of his argument and the necessity for his proffered solutions. Economic logic may prove that shifting of corporate income taxes from the taxpayer to, say, the consumer is very nearly impossible but the reader may form a different opinion from his own experience and observation. In another connection the author contends that corporate taxation and its child, double taxation, under the present tax structure discourage investment and risk-taking, yet he is ready to admit that during the past decade the expansion of old and the launching of new enterprises have been without precedent. On his own assumption of full employment it is difficult to see how further investment could have been encouraged to take place without inflationary results. The oppressive incidence and deleterious effects of corporate and double taxation are repeatedly cited but Dr. Petrie admits that extensive relief from these features of business life may pose perhaps even greater difficulties in the realms of fiscal policy, politics, and social welfare. He also proves that the use of taxation as a means to economic control by government is at best a very blunt instrument and yet one cannot help but feel that its use has saved us all from more direct and perhaps harsher measures. These considerations leave the layman with the vague impression that the inequities or inequities of the present tax law, though real enough, appear more

formidable in book form than when revealed in instalments through successive changes in the law.

The general implication of his argument is that the tax law of today so severely limits the right of the taxpayer to arrange his affairs as to attract the minimum tax that the philosophy of seeking escape must be abandoned in favour of a frontal attack on the whole basis of the law itself. The necessity or even desirability of this revolution in attitude is open to question.

Scholarship of a high order is evident through the whole treatise and for so difficult a subject the presentation is clear and absorbing. The book may be of more interest to the economist and business consultant than to the lawyer, but the accountant and the business man will find herein a valuable contribution to the basic understanding of the principles of sound fiscal policy.

DOUGLAS D. IRWIN, B.A., C.A.
Toronto, Ontario

Accountant's Office Manual, by Charles S. Rockey, C.P.A.; published by Prentice Hall Inc., New York; pp. 373; price \$6.35 U.S.

This better than average study offers some very worthwhile solutions to the problems facing the practising accountant. The author is managing partner

of a firm of accountants and was past president of the Pennsylvania Institute of Certified Public Accountants and a former member of the Committee on Accounting Procedure of the American Institute of Accountants.

Subjects dealt with include the firm and its organization, specialized departments, the clients, accounting and reporting policies and practices, personnel, office policies and procedures, supplies and equipment, accounting for income and expenses.

The practitioner will be particularly interested in the handling of personnel, reduction of cost, the accounting system within the accountant's office, firm-client relations (including an exhaustive discussion of the determination of fees), and auditing and reporting methods and techniques.

The value of the book is further enhanced by an appendix with illustrative forms and agreements which could be instrumental in saving time and effort.

Although the author is more sympathetic to the problems of the accounting firm than to those of the individual practitioner, the book as a whole provides a wealth of information, based on experience, which could be used effectively by both firm partners and the sole practitioner.

EDMUND F. M. CACHIA, C.A.
Toronto, Ontario

La Position du Comptable Agréé Dans la Société Moderne

By George P. Keeping, C.A.

Sommaire du bilan actuel de la profession

PEU de temps après avoir connu le sujet de la causerie que je devais prononcer, j'ai fait un rêve peu banal.

Assis à mon bureau, simulant l'activité comme d'habitude, je lève les yeux et j'aperçois devant moi une dame d'une cinquantaine d'années qui vient d'entrer. D'une mise très élégante, elle me paraît tout de même bizarre, car dans la main gauche elle tient une bascule et dans la droite, une plume.

Comme tout gentilhomme, je la prie de s'asseoir et lui demande ce que je pouvais faire pour lui aider. "Je suis la profession des comptables agréés et quelqu'un veut m'acheter," me répond-elle. "Quel prix dois-je demander?"

Dans le monde actuel, cette conversation peut paraître étrange, même stupide, mais je vous assure que dans mon rêve tout semblait parfaitement normal. Très sérieusement, je lui demande si elle a un bilan. "Que pensez-vous", me dit-elle, "naturellement, mes livres sont toujours bien tenus et j'ai l'habitude de préparer un bilan tous les mois."

Ce disant, elle me présente un document sur lequel je lis ce qui suit:

ACTIF	
L'éducation des étudiants, au prix coûtant	\$ x
Moins—Réserve pour l'amortissement	x
Résultat	Zéro
PASSIF	
Dettes	Zéro

Et elle continue, sans me laisser le temps de parler: "C'est un joli bilan, n'est-ce-pas? J'ai toujours tenu une comptabilité extrêmement prudente. Tout mon actif a été amorti, peut-être même plus rapidement qu'il n'était nécessaire et je n'ai pas de dettes; je paye toujours comptant."

J'allais répondre qu'à mon avis un tel bilan ne pouvait pas susciter un prix très avantageux quand je me suis réveillé.

Laissant errer ma pensée, je me suis demandé: "Quel est le vrai bilan actuel de la profession? En quoi consiste notre actif? En quoi consiste notre passif? Et comment faut-il les évaluer?"

Un discours à la 50 ième assemblée annuelle, Québec, le 9 septembre

Je considère d'abord le passif et je suis d'accord avec le personnage de mon rêve. Nous n'avons pas de passif. Nous payons nos créanciers, peut-être pas toujours comptant, du moins assez promptement. Mais tout à coup il me vient à l'esprit que le vrai passif de la profession est un passif aux dimensions immenses, à savoir notre responsabilité aux yeux du monde. Quelle est l'étendue de cette responsabilité. Il est impossible de l'établir sans connaître la valeur de l'actif de la profession. Si, par exemple, l'actif ne vaut pas beaucoup, alors notre passif ou notre responsabilité se résume à peu de chose. D'autre part, si notre actif est considérable, notre passif est proportionnel. Donc, j'arrive à la conclusion profonde que la valeur du passif égale la valeur de l'actif, une situation assez normale dans la profession.

L'Actif de la Profession

Exammons maintenant l'actif. En quoi consiste-t-il? D'abord, je prends l'actif tangible. Une profession n'est qu'un groupement de personnes et tant valent les membres, tant vaut la profession. Qui en sont les membres? Des hommes ou des femmes privilégiés parce qu'ils font partie d'un régime démocratique et non communiste. Bien instruits, les uns de l'école jusqu'à l'immatriculation, les autres de l'université jusqu'au baccalauréat, les comptables agréés subissent un entraînement rigoureux et compréhensif, non seulement en comptabilité, mais aussi en loi, économie, mathématiques, *et caetera*. Donc je dis que l'actif tangible de la profession comprend des hommes demeurant ici au Canada, des hommes ayant bénéficié d'une culture générale de premier ordre et d'une formation technique excellente. C'est déjà quelque chose.

Qu'est-ce que nous avons comme

actif intangible? En première place, je choisis l'honnêteté et l'intégrité, parce que les fondements mêmes de la profession reposent sur ces deux qualités, et je peux dire sans crainte de me tromper que nous en sommes bien pourvus.

En second lieu, à mon avis, c'est l'éthique qui existe parmi les comptables agréés. Une profession est incapable d'aller de l'avant si une estime sincère et mutuelle ne règne pas entre ses membres. A ce point de vue, nous sommes également bien partagés.

Troisièmement, une qualité que nous possédons à un haut degré, c'est l'esprit public. Partout dans ce pays on trouve les comptables agréés se donnant bénévolement aux affaires de la communauté, de l'église ou aux œuvres de charité et autres.

Comme tout bon comptable, faisons maintenant l'addition. Nous arrivons, si je ne me trompe, à un résultat fort impressionnant dont nous devrions être fiers. Je suis d'opinion qu'un comptable agréé a toutes les aptitudes pour accepter les responsabilités les plus lourdes dans de nombreux champs d'activité tant dans son pays qu'à l'étranger et peut s'en acquitter avec tact et clairvoyance.

Le Passif de la Profession

Mais assume-t-il ces responsabilités actuellement? Exammons la situation.

Dans la pratique de la comptabilité publique, sa haute compétence est reconnue en matière de vérification des comptes ou de problèmes d'impôts. Comme conseiller en matière industrielle, commerciale et financière, il est extrêmement bien considéré. A la question "Est-ce qu'il porte les responsabilités les plus lourdes dans la pratique de la comptabilité publique?" je réponds sans hésitation, "Oui".

Quelle est sa situation dans la vie commerciale et industrielle? Il est président ou administrateur de diverses compagnies et il remplit également les postes de comptable en chef, contrôleur ou secrétaire-trésorier d'un nombre incalculable de firmes. Je me demande, cependant, s'il est reconnu à sa juste valeur dans le domaine de l'industrie. Dans la finance, il est rarement promu à un poste très élevé, alors qu'un directeur de ventes ou un chef d'usine deviendra fréquemment gérant-général. Je dois donc répondre "Non" à la question "Est-ce qu'il porte les responsabilités les plus lourdes dans l'industrie et dans le commerce?"

Observons-le maintenant au service de l'éducation et des recherches. Il n'y a pas de doute qu'il contribue généralement à l'éducation des stagiaires comptables à l'université ou ailleurs. Quant aux recherches, je donne deux exemples de son zèle. Premièrement, les bulletins du Comité des Recherches de l'Institut Canadien des Comptables Agréés guident non seulement les comptables agréés, mais aussi la vie financière du Canada. Deuxièmement, sa collaboration étroite avec les avocats au sein de la Canadian Tax Foundation lui permet de contribuer objectivement aux recherches. On pourrait citer beaucoup d'autres exemples de cette nature où il exerce son activité. Toutefois, ne l'oublions pas, l'espace à cultiver dans ce champ d'action est très vaste. On entend souvent dire que les troubles du monde sont pour la plupart d'origine économique; par conséquent, la panacée devrait se trouver dans la restauration économique. Le comptable agréé avec son entraînement et ses aptitudes est sûrement l'homme le mieux qualifié pour remédier à cet état de chose.

Je passe maintenant à sa participation dans les services gouvernementaux, soit municipal, provincial ou fédéral. A

mon avis elle est très limitée, car il n'y a que les départements de l'impôt qui bénéficient de ses connaissances. Mais son rôle consiste-t-il uniquement à extorquer de ses concitoyens l'argent gagné si péniblement? Dans mon opinion, il s'avèrera plus utile à ses semblables au service de l'emploi de ces argent. Je veux dire qu'il possède les qualités requises pour surveiller les frais et le bon fonctionnement des divers ministères. De plus, en ces temps difficiles où les rapports entre les nations dépendent davantage des affaires commerciales, n'est-il pas logique de se demander si le comptable agréé n'est pas mieux qualifié que quiconque à représenter notre pays à l'étranger et, même, à remplir la charge d'ambassadeur? Comme je le disais tout à l'heure, je constate que le comptable agréé peut assumer des tâches beaucoup plus lourdes que celles qu'on lui confie actuellement dans les services gouvernementaux.

Le dernier champ d'activité que j'examinerai est la vie politique. Quels devoirs les comptables agréés peuvent-ils se vanter d'avoir accomplis dans ce domaine? Du côté provincial, je n'ai pas fait de recherches, mais je sais bien que dans cette belle province éclairée le poste de Ministre de l'Industrie et du Commerce est confié à l'honorable M. Paul Beaulieu, C.A.; et en Colombie Britannique, après les récentes élections, M. E. M. Gunderson, C.A., a été nommé Ministre des Finances. Au fédéral, j'ai fait des recherches dont voici le résultat: Depuis le commencement du siècle nous avons subi treize Ministres du Revenu National dont six étaient des avocats, deux des hommes d'affaires qui ont passé presque toute leur vie dans la politique, un notaire, un journaliste, et un médecin. En ce qui concerne le Ministère des Finances, sept avocats, un homme politique voué es-

sentiellement aux affaires de l'état, un homme d'affaires et un journaliste se sont succédés.

Pas un seul comptable agréé dans tout le bazar!

Il me semble qu'un comptable agréé pourrait présenter un budget aussi précis que l'honorable M. Abbott, par exemple.

En dépit de certains horizons lui semblant à demi ouverts ou complètement fermés, il faut conclure de cette étude que le comptable agréé évolue progressivement et avantageusement quelque soit la tâche qu'on lui confie et la seule raison qui retarde l'avancement de notre profession dans certaines sphères c'est qu'elle n'est reconnue comme telle que depuis quelques années. Toutefois, il semblerait que nous souffrons d'un excès de modestie!

Le Danger de la Spécialisation

Cependant, un danger nous guette actuellement. Il n'est pas encore apparent, mais s'il prenait trop d'ampleur notre profession pourrait être abaissee au niveau d'un métier. C'est la *spécialisation*. Il ne faut pas être trop spécialiste, car compiler des chiffres sans considérer les valeurs morales tuerait le prestige du professionnel. Cette tendance n'existant pas au temps de nos ancêtres et Monseigneur de Saint-Vallier le confirmait hautement en parlant des élèves de la Grande Ferme de Saint-Joachim au Cap-Tourmente, au commencement du XVIII^e siècle, lorsqu'il disait: "Un certain nombre qui s'adonnaient aux lettres et à la théologie y apprenaient aussi un métier par divertissement entre leur études."¹ Il est entendu que la société moderne exige des compétences spécialisées à un degré beaucoup plus élevé

que celle du XVIII^e siècle, mais il faut se méfier de l'exagération qui serait funeste à la profession.

La production en masse est la fièvre de notre ère. Tout effort est dirigé vers l'invention de machineries capables de faire une seule opération plus rapidement, plus efficacement et à meilleur marché. Ca va pour la fabrication d'une machine, mais pas pour un homme. Cependant, il semble que le monde d'aujourd'hui tende à se tourner vers l'homme excellant dans une spécialité, plutôt que vers celui dont la faculté de penser est basée sur un jugement sûr (ici j'emploie le mot "penser" dans son sens pur — c'est-à-dire de se former dans l'esprit des idées). Il est vrai que l'homme d'aujourd'hui est bien plus au courant des affaires du monde que celui d'hier, mais cela ne veut pas dire qu'il puisse émettre une opinion claire et précise; il s'en remet trop souvent au journaliste, au commentateur ou à l'annonceur, quand celui-ci peut penser à sa place.

A ce sujet, permettez-moi de vous lire la citation d'un auteur contemporain, Antoine de Saint-Exupéry. Dans son oeuvre "Terre des Hommes", il parle des habitants des cités industrielles de l'Europe, un ou deux ans avant la dernière guerre. Je cite textuellement:

Il en est autres, pris dans l'engrenage de tous les métiers, auxquels sont interdites les joies du pionnier, les joies religieuses, les joies du savant. On a cru que pour les grandir il suffisait de les vêtir, de les nourrir, de répondre à tous leurs besoins. Et l'on a peu à peu fondé en eux le petit bourgeois de Courteline, le politicien de village, le technicien fermé à la vie intérieure. Si on les instruit bien, on ne les cultive plus. Il se forme une piètre opinion sur la culture celui qui croit qu'elle repose sur la mémoire de formules. Un mauvais élève du cours de Spéciales en sait plus

¹ "Au Coeur de Québec" par Marius Barbeau, p. 97

long sur la nature et sur ses lois que Descartes et Pascal. Est-il capable des mêmes démarches de l'esprit?

Comme je l'ai noté précédemment, le comptable agréé acquiert d'abord à l'école et à l'université une éducation générale de première qualité et ensuite une éducation technique sans égal. Il possède ou est sensé posséder les moyens de penser, mais sa destinée ne s'accomplira que dans la mesure où il perfectionnera son éducation, sa faculté de penser et sa culture.

Conclusion

Permettez-moi de comparer notre profession à différents champs de moisson: quelques-uns, bien cultivés, produisent une récolte abondante, d'autres sont moins généreux ou complètement stériles. Heureusement, je ne vois pas de mauvaises herbes; mais combien faut-il être aux aguets, car l'ivraie pousse à vue d'oeil. Ne ménageons donc ni nos efforts, ni nos peines à cultiver, protéger et épanouir notre domaine aux bornes illimitées.

Professional Notes

ALBERTA

Mr. Eric A. Geddes, C.A., announces the opening of an office for the practice of his profession at 16 Bradburn Thomson Block, Edmonton.

Calgary Chartered Accountants Club

The annual meeting of the Calgary Chartered Accountants Club was held on October 14, 1952. The following were elected to office for the coming year: *president*, R. E. Waller; *vice-president*, S. Horner; *secretary-treasurer*, J. H. Duck; *directors*, A. Johnson, H. Bliss; *auditor*, R. W. Hamilton.

BRITISH COLUMBIA

A. P. Gardner & Co., Chartered Accountants, announce the opening of an office in the Willis-Harper Block, Quesnel.

Mr. H. S. Bardal, C.A. announces the opening of an office for the practice of his profession at 918 Standard Bldg., Vancouver.

MANITOBA

Manitoba Students Society

The Chartered Accountants Students' Society of Manitoba has published its first annual year book for the benefit of its members. As well as containing standard "year book" material, such as by-laws and lists of executive and

committees, this attractive little red book treats its readers to a "date" section, photographs taken at recent social functions, and personalized jokes designed to apply to various members of the Society. We only wish we knew the individuals concerned.

Both the Manitoba Students' Society and the Year Book Editor, Barry Iliffe, deserve a large measure of praise for this achievement, especially since it must represent the labour of many spare hours given by many busy students.

NEW BRUNSWICK

Mr. G. Kenneth McKenzie, C.A. announces the opening of an office for the practice of his profession at 366 Douglas Ave., Saint John.

ONTARIO

Macdonald & Healey, Chartered Accountants, announce the admission to partnership of Messrs Arthur M. Grainger, C.A. and Joseph F. Tomsich, C.A. Practice will be carried on under the firm name of Macdonald & Healey, Chartered Accountants, at 504 Bartlet Bldg., Windsor, and 172 King St. W., Chatham. Mr. Frederic C. Standing, C.A. has been appointed resident manager of the Chatham office.

ONTARIO

Mr. John Funk, C.A. announces the opening of an office for the practice of his profession at 21 Division St., Welland.

Hamilton and District C.A. Association

The Hamilton and District Chartered Accountants Association held its second meeting last fall at the Royal Connaught Hotel. Mr. Glen E. Martin, partner of Peat, Marwick, Mitchell & Co., Chicago spoke on "A Business Survey Approach to Auditing". Herbert Elwell, C.A. acted as chairman.

PRINCE EDWARD ISLAND

The semi-annual meeting of the P.E.I. Institute of Chartered Accountants took place on October 16 at the Queens Hotel, Charlottetown. Speakers included Messrs Lorn McLean, C.A., president of the C.I.C.A., C. L.

King, F.C.A., secretary of the C.I.C.A., and W. A. Morrell, F.C.A. Eighteen students of the Institute were guests at the meeting.

QUEBEC

Mr. Paul E. Trudel, C.A. announces the opening of an office for the practice of his profession at 306 Aldred Bldg., Montreal.

SASKATCHEWAN

Regina Chartered Accountants Club

The Regina Chartered Accountants Club's elections for the coming year took place in November. New *president* is Glyn Myers, *vice-president* F. Copithorne, and *secretary-treasurer*, H. J. Pointer. Lloyd Robinson and C. F. Westerman were elected as committee members. The guest speaker at the meeting was J. R. M. Wilson of Toronto and Walter Read was chairman.

News of Our Members

A Maritime Chapter of the American Association of Hospital Accountants has been organized and Mr. W. W. B. Dick, C.A. (N.B., N.S., P.E.I.) has been named one of the directors of the Association. On November 25 to 28, a committee under the chairmanship of Mr. Dick held the first Hospital Accounting Institute in Moncton, the purpose of which was to promote uniformity and efficiency in hospital accounting. It was an intensive meeting with a total of six hours of lectures and study each day and an address on some aspect of hospital accounting each evening.

Mr. Philip Clark, C.A. (Ont.), has been elected to the executive of the National Tax Association.

Mr. J. W. Dixon, C.A. (P.E.I.), has been

appointed Director of Taxation, Department of National Revenue, Fort William, Ont.

Mr. John Herbert Ferrie, C.A. (Que.), is the new president of the Canadian Exporters Association.

Mr. A. F. Gosling, C.A. (N.B.), was guest speaker recently at a meeting of the Society of Industrial and Cost Accountants, Moncton Chapter.

Mr. Henry G. Norman, C.A. (Que., Alta., N.B.), was named Canada's first Ambassador to Venezuela on November 21, 1952.

Mr. W. T. Reid, C.A. (Sask.), has been elected president of the provincial council of the Society of Industrial and Cost Accountants of Saskatchewan.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

IN our moments of leisure we have thought of many brilliant replies to hypothetical questions; and if there be those who fail to see what is brilliant about us we are sure that it is only because they have failed to ask the right question at the right time.

For example, we have been waiting patiently for some malevolent fellow, trying to catch us unawares, to ask, "What are accountants trying to do anyway?" For that we have an answer which readers of these notes and comments may be able to guess. We should say, "Accountants are dedicated to the measurement of income."

Not that this reply tells the whole story by any means, or that it is even appropriate at all in particular cases, but it does have the advantage of being a constructive reply available at a strategic time. (Cost accountants, for example, might explain the purpose of accounting in terms of promoting industrial efficiency). In any case we think our reply is infinitely superior to such other possible replies as, "The same as last year", or "Trying to balance the books", or even, "I don't know" (followed by a sigh).

* * * *

It is still probably true that the accountant stands justified in the court of public opinion largely for the fact he can prepare a balance sheet. Then if we say that the purpose of accounting is to

measure income, we may be called upon to say what we think is the purpose of the balance sheet.

We are prepared for this question too. We should say that the balance sheet is important for showing the methods of arriving at the amounts stated for the various assets. We should say that among the most important things the balance sheet discloses (or should disclose) are the "bases of valuation" of the different assets, and whether any basis of valuation has been changed since the preceding balance sheet.

The balance sheet is important for disclosing the *methods* of computing income. The figure for income is directly dependent upon the "valuations" (an unhappy word) placed upon the assets. The figure for income is locked in place, as it were, by the amounts at which the assets are stated on the balance sheet (apart, at any rate, from such an item as "appraisal surplus").

To be more specific: the figure for accounts receivable on a balance sheet is subject to a deduction for allowance for doubtful accounts, and if the allowance is increased the change is reflected in bad debts expense in the income statement. Likewise if the amount shown for merchandise inventory on the balance sheet were to be changed, the figure for cost of goods sold in the income statement would have to be changed. Again, fixed assets (other than land) are shown

on a balance sheet with allowances for depreciation deducted from the respective costs. That is the usual "basis of valuation" for fixed assets. And any increase in an allowance for depreciation as it appears on a balance sheet is reflected in the depreciation expense recorded in the income statement.

* * * *

It is fair to add that some accountants would state the purpose of accounting in more general, and possibly more altruistic, terms than the measurement of income. There have been a number of accountants who have thought of accounting simply in terms of "telling the truth" — not of course that those who have failed to express themselves in this way would do otherwise. We list below three such statements of the purpose of accounting, from somewhat different points of view.

I have reviewed the first edition of this book which was published in 1912. I find that I then stated the prime purpose of auditing to be the discovery and disclosure of truth. I have consistently adhered to that belief.

—R. H. Montgomery, in the Preface to the seventh edition of "Auditing".

Thus it is my belief that we shall only maintain and promote our status in academic circles if we tackle the claim of accounting as a technique to be perfected in the service of unfolding truth.

—F. S. Bray in
"The Accounting Mission"

Although theory . . . is rooted in problems of classification its essence lies deeper than the separation of statistical categories. It reaches down to such basic elements as honesty and truth, considered in the light of the parties at interest and the purposes to be served by accounting.

—A. C. Littleton, "The Uses of Theory",
The Journal of Accountancy, April 1939.

A PUZZLE FOR JANUARY

Four comrades had brought in five prisoners — a German, an Italian, a Rumanian, a Spaniard, and a Hungarian — and, having labelled each with a different letter, they made the following statements to the Commissar. Each, I regret to say, made only one correct statement.

Fibkin: A is not Spanish, B is not German, C is Italian.

Leisky: D is Spanish, B is not Rumanian, C is not Hungarian.

Notzo: E is not Rumanian, A is German, D is not Italian.

Truthizov: B is Hungarian, E is not Italian, C is not German.

Assign correct nationalities to A, B, C, D, and E.

(Submitted by a Toronto reader)

SOLUTION TO THE CHRISTMAS PUZZLE

Let x be Monica's age in 1929

Let y be the number of years by which Monica's age exceeds Mabel's.

Then in 1929 Father gave $fx + (x - y)s$. (1)

Subsequently he gave $fx + (x + y)s$. (2)

$fx + (x + y)s - [fx + (x - y)s] = 10s$

$2y = 10$

Monica is five years older than Mabel.

CORRESPONDENCE

*Windsor, Ontario*RE: NOTES AND COMMENTS IN THE
STUDENTS' DEPARTMENT NOV 1952

Sir: We thought you might be interested to know that a great many firms of practising accountants have not bothered with adjusting and reversing entries for such items as prepaid and accrued expenses, provision for bad debts, depreciation, etc. Separate columns are provided on the working papers for adjustment of the general ledger figures. Setting up the closing entries from the revenue and expense columns leaves the correct debit and credit balances in the expense accounts without further entry. In the case of provision for bad debts and depreciation, the expense account credits are posted directly to the reserve accounts.

F. LORENZEN, C.A.

The Editor's Reply

(excerpt from letter to Mr. Lorenzen)

I am aware that various short-cuts are often taken at the end of the year (in particular the one you refer to) for the purpose of adjusting and closing the accounts; but, for a good reason I think, text books illustrate actual year end adjusting entries, and beginning-of-period reversing entries. In my opinion a student will acquire a better understanding of the purpose of the year end adjustments if he first learns to prepare adjusting and closing journal entries. Only in that way do the various account titles in the ledger agree with the description of the account balances appearing in the financial statements. For example,

as a result of a calculation on a work sheet, an expense account may be credited at the year end with an amount larger than the debit balance. The resulting credit balance is of course an accrued liability; but it appears under an "expense" title. This must be very confusing to a student who has not been previously taught the adjusting and reversing entries, and the reason for them. Only if the student recognizes the work sheet method for the short-cut that it is can he understand the technique.

Mr. Lorenzen's Rejoinder

I am not certain that the present system of instruction on this subject really leads to any better understanding. Does it not bear a very close resemblance to the old-fashioned English practice that an auditor was not fully trained unless he had first spent two years becoming a skilled *additor*, which tradition ignored the manifold advantages of comptometer operators and adding machines, etc. until the last ditch?

As a student, subsequently as a tutor, and latterly for the past 25 years in assisting students, I have found that the courses of training seem to lead students to try to learn that certain expense accounts go *here* or *there*, and certain entries are made *this way* or *that way*, ignoring the important subject of *why* the expense accounts go here. With little understanding, it is too easy for the memory to slip or a new matter crop up not covered in the memory work. Once the principles are thoroughly understood, the simpler system falls into place naturally.

PROBLEMS AND SOLUTIONS

Qualified accountants have prepared the solutions appearing in this section, and the solutions reflect the personal views and opinions of their various contributors. Students should not regard them necessarily as models for submission to the examiner. The hope is rather that they will provide a basis for such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1
Final Examination, October 1951
Accounting III, Question 4 (10 marks)

The following balance sheets of the M. Holding Co. Ltd. and its two subsidiaries, the N Co. Ltd. and the O Co. Ltd., have been drawn up as a basis for the preparation of the consolidated balance sheet.

BALANCE SHEETS

as at 31 Aug 1951

	M. Holding Co. Ltd.	N Co. Ltd.	O Co. Ltd.
Assets			
Current assets	\$179,000	\$140,000	\$ 20,000
Property less reserves	55,000	136,300	12,800
Investment in N Co. Ltd. stock — 70%	44,000		
— 20%			13,700
Investment in O Co. Ltd. stock—100%	31,000		
Investment in N Co. Ltd. bonds	40,000		
	\$349,000	\$276,300	\$ 46,500
Liabilities			
Current liabilities	\$ 90,000	\$ 80,300	\$ 15,000
Bonds payable		100,000	
Capital stock	225,000	60,000	45,000
Surplus at the date shares were acquired		6,000	1,500
Earned surplus (deficit)	34,000	30,000	(15,000)
	\$349,000	\$276,300	\$ 46,500

The investments in the O Co. Ltd. stock are carried at cost less subsequent net losses.

The investment in N Co. Ltd. stock are carried at cost.

The bonds of the N Co. Ltd. were purchased at par.

Required:

The consolidated balance sheet of the M Holding Co. Ltd. and its subsidiaries as at 31 Aug 1951.

A SOLUTION

M. HOLDING CO. LTD. AND SUBSIDIARIES N CO. LTD. AND O CO. LTD.

CONSOLIDATED BALANCE SHEET

as at 31 Aug 1951

ASSETS

Current assets	\$339,000
Property less reserve	204,100
	\$543,100

The Students' Department

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LIABILITIES AND CAPITAL

Current liabilities			\$185,300
Bonds payable	\$100,000		
Less bonds held in treasury	40,000		
			60,000
Minority interest			9,600
			<hr/>
Total liabilities			254,900
Capital and surplus			
Capital stock	225,000		
Earned surplus	61,000		
Excess of book value of subsidiary shares acquired over cost at time of acquisition	2,200		
			<hr/>
			288,200
			<hr/>
			\$543,100
			<hr/>

M HOLDING CO. LTD. AND SUBSIDIARIES N CO. LTD. AND O CO. LTD.

WORK SHEET FOR CONSOLIDATED BALANCE SHEET

as at 31st August 1951

A S S E T S

M Holding Co. Ltd.	N Co. Ltd.	O Co. Ltd.	Adjustment	Consolidation
Current assets	\$179,000	\$140,000	\$20,000	\$339,000
Property less reserve	55,000	136,300	12,800	204,100
Investment in N Co. Ltd.	44,000		(1) Cr. \$46,200 (2) Cr. 13,200 (4) Dr. 15,000 (3) Cr. 46,500	GW (2,200) GW 500 GW (500)
Investment in O Co. Ltd.	31,000			
	<hr/> <u>\$309,000</u>	<hr/> <u>\$276,300</u>	<hr/> <u>\$46,500</u>	<hr/> <u>\$540,900</u>

L I A B I L I T I E S

Current liabilities	\$ 90,000	\$ 80,300	\$15,000	\$185,300
Bonds payable		100,000		100,000
Less bonds held by M Holding Co. Ltd. (40,000)				(40,000)
Capital stock	225,000			225,000
			(1) Dr. \$42,000 (2) Dr. 12,000 (3) Dr. 45,000	MI 6,000
Surplus at date of acquisition	6,000	45,000	(1) Dr. 4,200 (1) Dr. 1,200 (3) Dr. 1,500	MI 600
Earned surplus	34,000	30,000	(15,000) (4) Cr. 15,000	MI 3,000
	<hr/> <u>\$309,000</u>	<hr/> <u>\$276,300</u>	<hr/> <u>\$46,500</u>	<hr/> <u>\$540,900</u>

GW = Goodwill of consolidation = difference between book value of subsidiary shares acquired and cost at time of acquisition

MI = Minority interest in N Co. Ltd.

Editor's note:

Consolidated surplus at 31 Aug 1951 comprises the following:

Earned Surplus M Holding Co. Ltd.	\$34,000
Share of O Co. Ltd. (100% owned by M Holding Co. Ltd.) in increase in surplus of N Co. Ltd. since acquisition: 20% of 30,000	6,000
Share of M Holding Co. Ltd. in increase in surplus of N Co. Ltd. since acquisition: 70% of 30,000	21,000
Share of M Holding Co. Ltd. in deficit of O Co. Ltd. since acquisition: 100%	(\$15,000)
<i>Less</i> already charged against Earned surplus of M Holding Co. Ltd. when adjusting Investment in N. Co. Ltd. stock for subsequent losses	15,000
Consolidated surplus 31 Aug 1951	\$61,000

In the editor's opinion the problem might have been worked without a work sheet of the kind shown in the solution, by making the above calculation.

PROBLEM 2

Final Examination, October 1951

Accounting III, Question 5 (18 marks)

Answer any *Three* of parts (a), (b), (c), or (d).
(6 marks for each part)

- (a) In the accounts of a fire and casualty insurance company:
 - (i) What does the reserve for unexpired premiums represent?
 - (ii) How is this reserve calculated at the year end date?
- (b) In the balance sheet of a stock broker's business:
 - (i) What classification should be made of the clients' accounts and securities held on accounts of clients?
 - (ii) What is the purpose of such classification?
- (c) In the accounts of a municipality:
 - (i) Distinguish between current and capital types of accounts.
 - (ii) Set out the journal entries to record the following transactions, classifying the accounts as to current or capital:
 - (a) Advance of \$10,000 from current revenue to school board for construction purposes.
 - (b) Issue of 4% debentures in the amount of \$30,000, which was spent by the town on local improvements. Such improvements are to be paid for by the property owners of the town over the next 15 years.
 - (c) Payment in advance by one taxpayer of his whole assessment of \$1,000 re local improvements.
 - (d) Redemption of \$10,000 serial debentures issued to finance public work project.
- (d) In accounting for a flour mill:
 - (i) What do you understand by the term hedging?
 - (ii) Discuss the treatment of income or loss resulting from hedging transactions.
 - (iii) Set out the rules for the valuation of inventories of wheat on hand at the year end date.

A SOLUTION

- (a)
- (i) Portion of premiums paid in advance deferred to the later periods in which they will be earned.
 - (ii) In Canada insurance companies can assume all business during the year was written as of 1st July. Premiums are grouped by terms of policies, i.e., one year, two, three, four or five years. For each class the proportionate premium unearned is calculated as at the 31 December fiscal year end date. For example, a one year policy is 50% unearned at that date and a two year policy is 75% unearned at the end of the first year and 25% unearned at the end of the second year.
- (b)
- (i) Fully margined accounts. (1)
Undermargined accounts. (1) (2)
Partly secured accounts. (1) (2) (3)
Unsecured debit balances.
Free credit balances.
Cash settlement accounts. (1)
In (1) the balance of the accounts, the securities held and their value.
In (2) also the amount undermargined.
In (3) also the amount undersecured.
 - (ii) Since the securities held for any client are not to be used except as security against the accounts of that client, such a classification not only relates the securities to accounts for which they are held but also separates those groups of accounts which are not fully secured and which might not be so disclosed if all accounts and securities were lumped together.
- (c)
- (i) In a municipality capital accounts relate to those expenditures, usually for assets of an enduring value, which are not provided by funds raised by taxes in the year of expenditure and to the related revenue accounts.
 - (ii)

(a) Dr. Payments to school board	\$10,000
Cr. Cash	\$10,000
To record transfer to school board of part of funds received on school board levy.	
Current	

(b) Dr. Cash — Capital fund	30,000
Cr. Debentures payable	30,000
To record sale of \$30,000 — 4% debentures at par — debentures repayable in 15 equal annual instalments of \$_____.	

(c) Dr. Cash — Capital fund	1,000
Cr. Commutation Reserve	1,000
or	
Due from Abbutter	
or	
Local Improvement Taxes Receivable	
To record receipts of \$1,000 from _____ covering his full assessment re _____ see local improvement debenture issue _____ above.	

Capital		
(d) Dr. Debt redemption expense	10,000	
Cr. Cash		10,000
To record redemption of \$10,000		
serial debentures. Reference _____.		
Current		
Dr. Debentures Payable	10,000	
Cr. Capital Surplus		10,000
or		
Fixed Assets		
To record redemption of \$10,000		
serial debentures. Reference _____.		
Capital		

(d)

- (i) Protecting the mill against losses due to changes in the cost of grain occurring between the date of buying the grain and the date of selling the flour. It is accomplished by selling futures at the time the grain is purchased and buying futures at the time the flour is sold.
- (ii) Income or loss results from hedging operations only when the spread between cash and futures varies between the date of the selling of the futures and the date of the buying of the futures. Such a profit or loss would be an operating profit or loss and recorded in the profit and loss statement unless it was so large as to distort the figure for reported profit.
- (iii) Wheat is valued at market price less estimated costs to sell.

Editor's note: In the editor's opinion, the solution to part (c) (i) above merits discussion. There are some "expenditures which are not provided by funds raised by taxes" which belong to the current fund — e.g. expenditures from the proceeds of licenses. And the reference to the "related revenue accounts" has the editor stumped, unless the person who prepared the solution was thinking of debentures payable as a "revenue" account; although it may be possible that the proceeds of a debenture issue, not yet spent on capital assets, may earn interest as a savings account balance.

With a view to stimulating readers, the editor offers the following solution to part (c) (i) for what it is worth:

Capital fund accounts record expenditures financed out of proceeds of debenture issues, and the corresponding debenture debt. Sometimes long term assets acquired by way of gift (e.g. gift of \$100,000 for a swimming pool) are set up in capital fund accounts.

Current fund accounts record (i) current revenues (tax levies, license fees, etc.), (ii) expenditures out of current revenues (street maintenance, charitable grants, etc.), and (iii) the related asset and liability accounts (taxes receivable, debenture interest due but unpaid, etc.).

The editor will welcome criticism of his alternative solution by readers.

